Financial History

The magazine of the Museum of American Finance

The Evolution of Value Investing

All the Presidents' Bankers

The Origins of US Credit Unions

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1776 $1 Continental Currency Dollar, the finest of two known examples, sells for $1.41 million.

Produced by the Treasury Department in the late 1860's, Fractional Currency Shields are thought to have been made to be used in banks and post-offices for counterfeit detection - this nice example brought nearly $10,000 in Heritage's April CSNS Currency Auction in Chicago.

Nearly 700 U.S. Colonial coins from the Eric P. Newman Collection sold to a packed house for over $11 million on May 16-17th - with all proceeds going to charitable endeavors.

1783 Nova Constellatio 100 Units Silver Coin, the first pattern coin issued by the newly independent United States, achieves $705,000.

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MU$EUM OF AMERICAN FINANCE

www.MoAF.org

IN THIS ISSUE FEATURES

IN THIS ISSUE DEPARTMENTS

ON THE COVER

Benjamin Graham, known as the father of value investing, relaxing at his cluttered desk. This year marks the 120th anniversary of Graham's birth, as well as the 80th anniversary of the publication of his groundbreaking book, *Security Analysis*. See related articles, pages 6, 8 and 20.

Time & Life Pictures/Getty Images

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Museum Launches P-Credit Course for Teachers and Renews Free Student Summer Program

Message to Members

David J. Cowen | President and CEO

The Museum's program offerings and visitorship numbers have never been stronger. So far this year, the Lecture/Symposia Series has featured Sheila Bair, former head of the FDIC during the recent credit crisis; Alan Blinder, former vice chair of the Federal Reserve Board; and Carrie Schwab-Pomerantz, a leading financial literacy advocate. Our Lunch and Learn Series has been robust with eight speakers in the last three months, including Vanguard founder Jack Bogle and Museum founder John Herzog. We have also expanded our classes to NYC teachers who can now receive continuing education credit by attending our intensive 36-hour course on personal finance over a six-week period, led by Director of Education Chris Meyers. And in the first four months of this year, the number of individual visitors to the Museum was up 47%, demonstrating that the Museum is becoming a visitor destination.

Our Board of Trustees continues to expand, and we welcome the addition of Andrew Soussloff, recently retired from the Sullivan and Cromwell law firm. The Board committees have been very active, and I would like to thank the board members on those committees, as well as their chairs: Andrea de Cholnoky (Nominating), Al Hurley (Strategic Planning), Brad Kopp (Development) and Susan Stupin (Special Events).

The Museum has recently received a grant to partially underwrite an audio tour system for the permanent exhibitions, and we thank Con Edison and our board member, Bob Muccilo, for that support. We have also received support from institutional broker dealer R.W. Pressprich, led by board member Ed Rappa, to underwrite for the second consecutive year free student admission during the summer months. This sponsorship also includes programs with the Boys Club of New York, as well as complimentary historical stock certificates for all student visitors between Memorial Day and Labor Day.

We are proud of these achievements. The only independent finance museum in the nation, this unique non-profit exists due to the generosity of others, and we always need your support to interpret the events in the exciting future ahead. There will be important opportunities for the financial services industry to become more involved as trustees, advocates and major supporters of the Museum. Please call me to talk about the Museum and your future. $

Elsa Ruiz

David Cowen, president, with John Herzog, founder and trustee *emeritus*.

MAY 1 1956

Seven local investors contribute $105,000 to an investment partnership that a 25-year-old is about to start running from his bedroom in a rented house in Omaha. The name of the "kid" running the fund is Warren Buffett.

MAY 31 1974

The first money-market mutual fund with check-writing privileges, Fidelity Income Trust, opens for business.

MoAF Center for Financial Education Launches Class on Financial Bubbles

By Julia Orr

What goes up must go down. For one of the Museum's newest course offerings, that idiom does not relate to gravity but to the ebb and flow of stock market bubbles. The class, "Booms, Bubbles and Busts," uses political cartoons to help students understand the pattern of these booms and busts.

The bubbles class uses object-based learning to explore financial history. With the facilitation of the teacher, students examine period political cartoons depicting different stock market busts in history and answer three questions in order to develop a statement of what happened to the financial markets in this episode. These questions (from the Visual Thinking Strategy method of teaching) are:

1. What is going on in this picture?
2. What do you see that makes you say that?
3. What more can we find?

These questions require the students to find evidence to support their answers, as well as listen to other students' opinions about what they see in the cartoons. Not only does the bubbles class allow students to build collaboration and inquiry skills, it uses an interactive timeline to depict the pattern of bubbles and government reactions throughout history. Students leaving the class understand that market busts are a constant feature in history and that the government can only respond retroactively without stemming innovation.

Remember this the next time you visit the Museum: object-based learning and visual thinking strategies can be applied outside of the classroom too. Try looking at a picture of a trading pit and asking yourself these questions: What is happening in this picture? Why do I say that? Is there anything else I can see? $

Museum of American Finance

"Panic, as Health Officer, Sweeping the Garbage Out of Wall Street," published in the *Daily Graphic*, 1873.

Julia Orr is the Museum's 2013–14 Ruth Baker Financial Education Intern and creator of the financial bubbles class. She recently graduated from New York University with a Master's in Museum Studies.

JUN 3 1775

The national debt of the United States is born, as the Continental Congress authorizes a loan of six million pounds sterling to buy gunpowder.

JUN 12 1928

After more than 130 years of trading, the New York Stock Exchange finally has its first day on which more than five million shares trade hands, as total daily volume hits 5,252,425 shares.

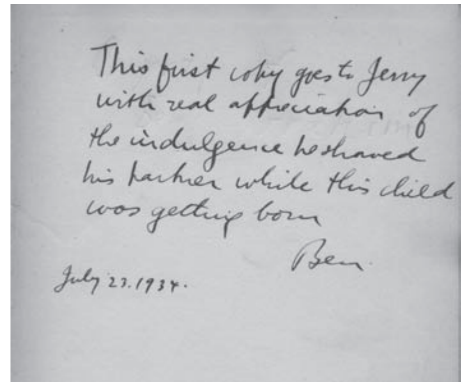
Museum Displays Graham-Newman Collection Materials at NYSSA Value Investing Conference

By Kristin Aguilera

This year marks two significant anniversaries for value investing: the 120th anniversary of the birth of Benjamin Graham, known as the father of value investing, and the 80th anniversary of the publication of the ground-breaking book, *Security Analysis,* which Graham wrote with David Dodd in 1934.

To honor Graham and the continuing legacy of his work, the New York Society of Security Analysts (NYSSA) hosted a full-day conference featuring keynote presentations by Howard Marks and Paul Hilal and panel discussions with some of today's top value investors on topics including shareholder activism, short selling and investing in distressed securities.

The Museum participated in this event by displaying some of the highlights from its Graham-Newman Collection, including the first copy of the first edition of *Security Analysis* signed by Graham to his business partner, Jerome Newman; an inscribed copy of the first edition of Graham's *The Intelligent Investor* from 1949; and business documents and pieces of correspondence from the Graham-Newman partnership. To view items from this collection online, please visit the Museum's Flickr page at www.flickr.com/photos/financemuseum. $


This first copy goes to Jerry with real appreciation of the indulgence he showed his partner while this child was getting born
Ben
July 27. 1934.

Museum of American Finance

Inscription in the first copy of the first edition of *Security Analysis*.

"Fed at 100" Exhibit Opens in China

By Kristin Aguilera

An expanded traveling version of the Museum's "Fed at 100" exhibit is now on view in Tianjin, China, at the Chinese Museum of Finance. The exhibit commemorates the centennial anniversary of the Federal Reserve System and will be simultaneously showing in New York through Spring 2015.

The Museum of American Finance and the Chinese Museum of Finance are two of the founding members of the International Federation of Finance Museums (IFFM), which is comprised of more than a dozen finance-themed museums from around the world. The consortium met for the first time in June 2013 in New York to discuss potential areas of cooperation, and this exhibit marks the first major international collaboration for the Museum of American Finance.

The IFFM will reconvene this fall in Italy and next year in China, where members will participate in an international finance museum expo. Museum of American Finance President/CEO David Cowen co-chairs the organization, along with Annamaria Lusardi from the Global Financial Literacy Excellence Center at George Washington University. $

The Museum's "Fed at 100" exhibit, on view at the Chinese Museum of Finance in Tianjin.

JUN 16 1903 Henry Ford launches the Ford Motor Co. in a refurbished wagon factory in Detroit, with $28,000 raised from 12 investors, including a coal dealer, a carpenter and a man who made windmills.

JUN 24 1997 The New York Stock Exchange begins quoting share prices in 1/16th, nicknamed "steenths" or "teenies."

Volunteer Spotlight: Greg Brennan

By Kristin Aguilera, Deputy Director

Greg Brennan began volunteering at the Museum in 2008, shortly after the Museum opened on Wall Street. A neighborhood resident with a lifelong passion for financial history, Greg was an ideal candidate to lead tours of the exhibits, and he became one of the Museum's first regular docents. A year later, Greg expanded his role at the Museum and began teaching the popular "Financial Markets" class in the Center for Financial Education to high school and college students, as well as professional groups.

Greg's interest in finance began in his teens, when an uncle introduced him to the stock market. He did not pursue finance in college, however, and instead earned a B.S. in Psychology and a Master's in Public Administration. For 10 years, Greg worked in the area of economic development, bringing investments into companies in Russia and the Ukraine for the International Executive Service Corps.

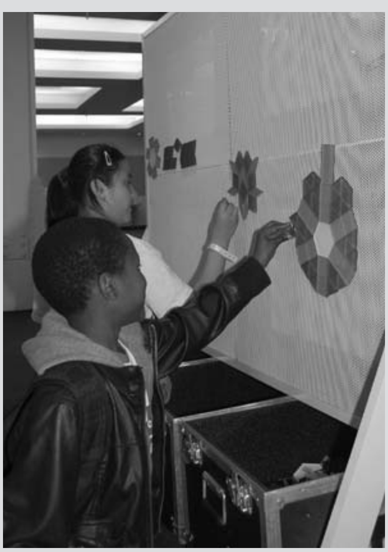
An entrepreneur at heart, Greg left that position to start his own company—a textile business producing knit sweaters in New York and New Jersey. That business was short-lived, but he moved on to start a successful newsletter with his wife that analyzed industries in China. Their main clients were businesses and law firms, as the newsletter covered regulatory changes and issues related to investments in various industries, especially energy and manufacturing.

Five years later, Greg and his wife were able to start their dream business. They opened the equity research firm of TH Capital, which they still run today, along with three other partners. The company offers research on Chinese companies that are traded in the United States, mostly on the NYSE and the NASDAQ. Greg runs the New York office, while his wife—a native of China—divides her time between New York and the company's main office in Beijing. Most of their clients are US hedge funds.

Greg said his favorite aspect of volunteering at the Museum is the interaction with a community of people with a similar interest in financial history. He also enjoys the physical proximity to the collections, and the access to pieces of our nation's financial history that can be found nowhere else.

In his free time, Greg enjoys following hockey, especially the New York Rangers. He also loves dogs and can frequently be seen on Wall Street walking his French bulldog, "Nixie." $

MoAF and MoMath Team Up on Math Event for NYC Students



Paul Margolis

Students from the five boroughs of New York explored an installation of the Museum of Mathematics's "Math Midway" exhibit at the Museum of American Finance on May 31. The activities were part of a hands-on mathematics event organized by the NYC Department of Youth and Community Development.

JUN 27 1890 Congress creates the first pension in which age is part of eligibility, as any veteran over the age of 65 becomes entitled to a monthly payment of between $6 and $12.

JUN 29 1979 As the American auto industry sputters and the technology industry takes off, the editors of *The Wall Street Journal* boot Chrysler from the Dow Jones Industrial Average and replace it with IBM. And with healthcare growing faster than the food industry, Merck replaces Esmark.

The Graham-Newman Collection

By Becky Laughner,
Director of Exhibits and Archives

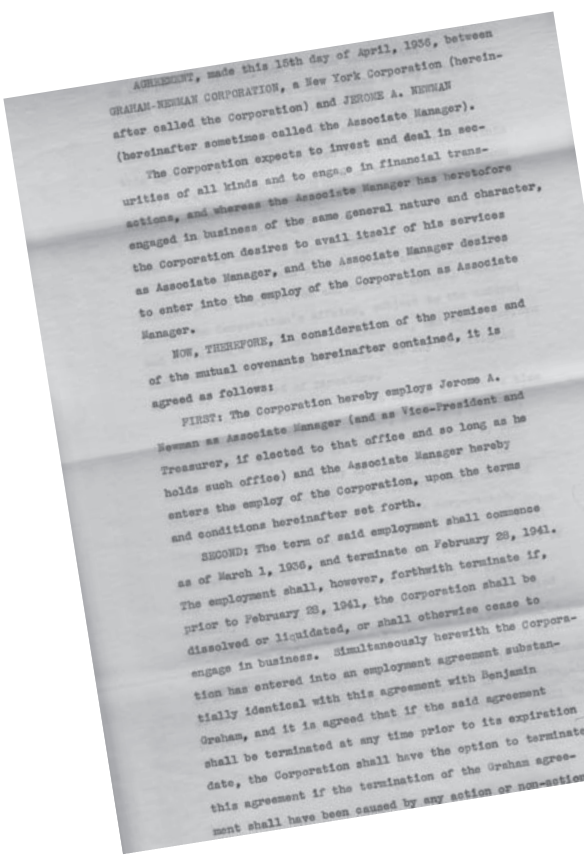
Benjamin Graham's contributions to the financial services industry are vast and varied. He is considered to be the father of value investing, and he made significant contributions to the standardization and professionalization of the field of security analysis. He was also the first to propose a formal standard for analysis and was the *de facto* founder of the Chartered Financial Analyst (CFA) designation. In addition to his fame as Warren Buffett's first boss and mentor, he is also the author of groundbreaking investment books, most notably *Security Analysis* and *The Intelligent Investor*. As a testament to the significance of these books, first published in 1934 and 1949, respectively, they remain in print and are still read widely today.

It is no wonder, then, that Graham's works have a place in the Museum of American Finance's collection. In 2007, the Museum received the Graham-Newman Collection from the family of Jerome (Jerry) Newman, Graham's long-time business partner. The collection chronicles the close business and personal relationship between the two men, as well as the personal life of Jerry Newman. The collection contains files, annotated newspaper clippings, scrapbooks, photos, documents and objects, including important material pertaining to Graham-Newman Corporation's founding and management structure, as well as Newman's research files and documents pertaining to his philanthropy and social life. There are also many early editions of Graham's books, several of which are inscribed.

The Museum's collections staff is in the process of digitizing this historically-significant collection so that it will be accessible to everyone. Below are a few highlights of the collection.

Graham-Newman Corporation Documents

Benjamin Graham and Jerome Newman formed the Graham-Newman Corporation in 1936 and operated the company until 1956. Between the Graham-Newman Corporation mutual fund and the partners' private fund, Newman & Graham, they managed about $12 million. Below are the first page of the founding agreement and a letter to stockholders about the fund's dissolution.



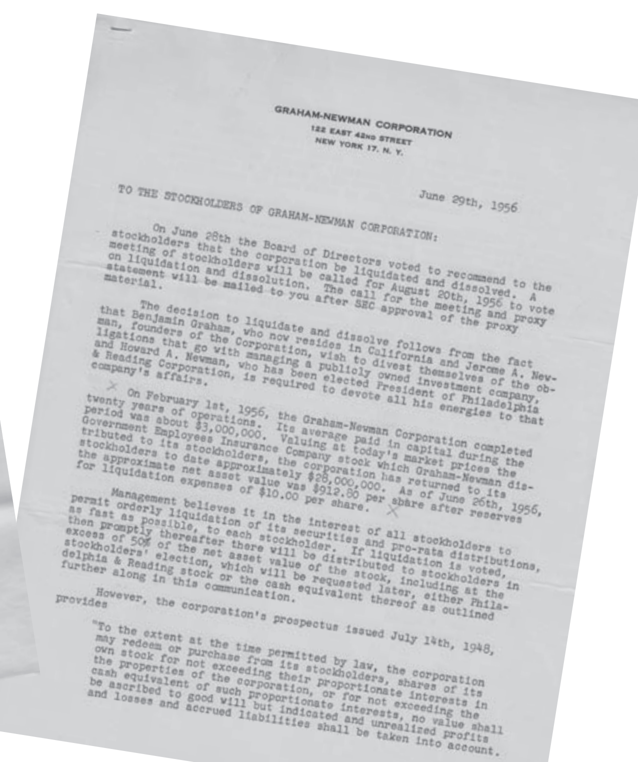
AGREEMENT, made this 15th day of April, 1936, between GRAHAM-NEWMAN CORPORATION, a New York Corporation (hereinafter called the Corporation) and JEROME A. NEWMAN (hereinafter sometimes called the Associate Manager).

The Corporation expects to invest and deal in securities of all kinds and to engage in financial transactions, and whereas the Associate Manager has heretofore engaged in business of the same general nature and character, the Corporation desires to avail itself of his services as Associate Manager, and the Associate Manager desires to enter into the employ of the Corporation as Associate Manager.

NOW, THEREFORE, in consideration of the premises and of the mutual covenants hereinafter contained, it is agreed as follows:

FIRST: The Corporation hereby employs Jerome A. Newman as Associate Manager (and as Vice-President and Treasurer, if elected to that office and so long as he holds such office) and the Associate Manager hereby enters the employ of the Corporation, upon the terms and conditions hereinafter set forth.

SECOND: The term of said employment shall commence as of March 1, 1936, and terminate on February 28, 1941. The employment shall, however, forthwith terminate if, prior to February 28, 1941, the Corporation shall be dissolved or liquidated, or shall otherwise cease to engage in business. Simultaneously herewith the Corporation has entered into an employment agreement substantially identical with this agreement with Benjamin Graham, and it is agreed that if the said agreement shall be terminated at any time prior to its expiration date, the Corporation shall have the option to terminate this agreement if the termination of the Graham agreement shall have been caused by any action or non-action



GRAHAM-NEWMAN CORPORATION
122 EAST 42ND STREET
NEW YORK 17, N. Y.

June 29th, 1956

TO THE STOCKHOLDERS OF GRAHAM-NEWMAN CORPORATION:

On June 28th the Board of Directors voted to recommend to the stockholders that the corporation be liquidated and dissolved. A meeting of stockholders will be called for August 20th, 1956 to vote on liquidation and dissolution. The call for the meeting and proxy statement will be mailed to you after SEC approval of the proxy material.

The decision to liquidate and dissolve follows from the fact that Benjamin Graham, who now resides in California and Jerome A. Newman, founders of the Corporation, wish to divest themselves of the obligations that go with managing a publicly owned investment company, and Howard A. Newman, who has been elected President of Philadelphia & Reading Corporation, is required to devote all his energies to that company's affairs.

On February 1st, 1956, the Graham-Newman Corporation completed twenty years of operations. Its average paid in capital during the period was about $3,000,000. Valuing at today's market prices the Government Employees Insurance Company stock which Graham-Newman distributed to its stockholders, the corporation has returned to its stockholders to date approximately $28,000,000. As of June 26th, 1956, the approximate net asset value was $912.80 per share after reserves for liquidation expenses of $10.00 per share.

Management believes it in the interest of all stockholders to permit orderly liquidation of its securities and pro-rata distributions, as fast as possible, to each stockholder. If liquidation is voted, then promptly thereafter there will be distributed to stockholders in excess of 50% of the net asset value of the stock, including at the stockholders' election, which will be requested later, either Philadelphia & Reading stock or the cash equivalent thereof as outlined further along in this communication.

However, the corporation's prospectus issued July 14th, 1948, provides

"To the extent at the time permitted by law, the corporation may redeem or purchase from its stockholders, shares of its own stock for not exceeding their proportionate interests in the properties of the corporation, or for not exceeding the cash equivalent of such proportionate interests, no value shall be ascribed to good will but indicated and unrealized profits and losses and accrued liabilities shall be taken into account.

JUL 1 1720 Stock in the South Sea Company, the first modern speculation, hits 950 pounds per share. Over the next four months, it loses roughly 80% of its value, and many speculators — including Isaac Newton — are wiped out.

JUL 2 1962 Sam Walton, a struggling retailer from Oklahoma, opens an 18,000-square-foot discount store in Rogers, Arkansas. He calls his store Wal-Mart.

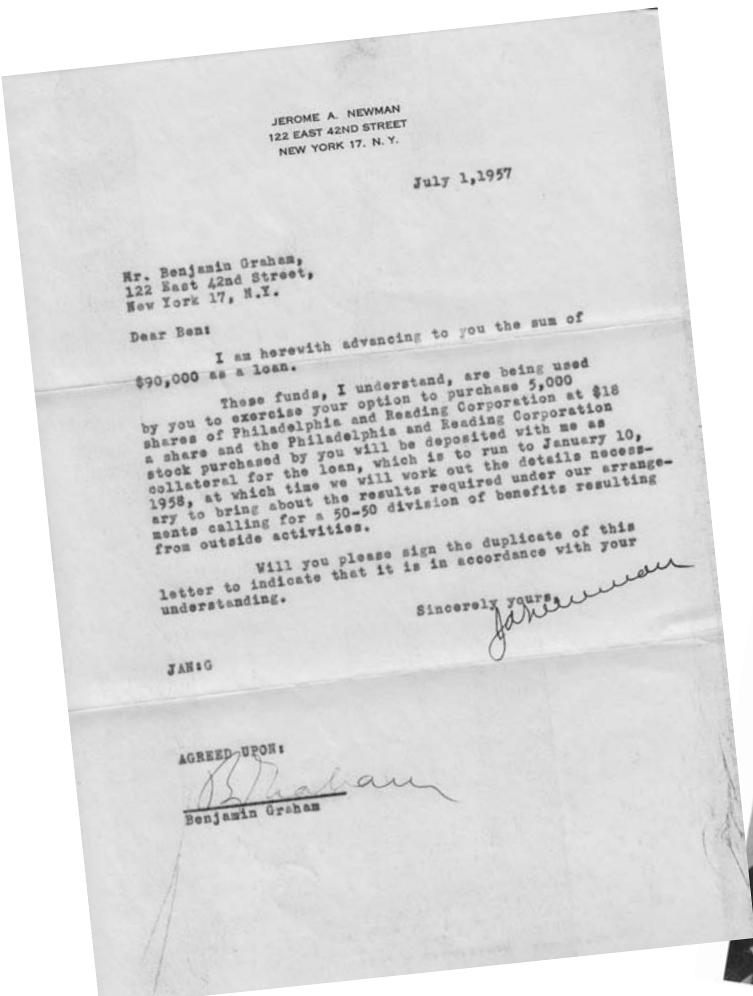
Letter Documenting $90,000 Loan

Graham and Newman were close professionally and personally. This letter documents a loan of $90,000 to Graham by Newman and also demonstrates the easy relationship between the two partners. The Philadelphia and Reading Corporation would become an important investment in the Graham-Newman Corporation portfolio.

GEICO Materials

The Government Employees Insurance Co. (GEICO) was one of Graham-Newman's most famous investments. In 1948, the partners purchased a 50% interest in the company, using approximately 25% of their fund's assets. Graham-Newman became closely associated with GEICO, and both Newman and Graham served on the insurance company's board. GEICO would also be associated with Graham's student, Warren Buffett, who purchased a great deal of the company's stock in 1978. It is considered to be one of Buffett's greatest investments. The Museum's collection contains many newspaper clippings and several documents that document Graham and Newman's investment in the company.

To view more of the Graham-Newman Collection, please visit the Museum's Flickr page at www.moaf.org/graham-newman. $



JEROME A. NEWMAN
122 EAST 42ND STREET
NEW YORK 17. N. Y.

July 1,1957

Mr. Benjamin Graham,
122 East 42nd Street,
New York 17, N.Y.

Dear Ben:

I am herewith advancing to you the sum of $90,000 as a loan.

These funds, I understand, are being used by you to exercise your option to purchase 5,000 shares of Philadelphia and Reading Corporation at $18 a share and the Philadelphia and Reading Corporation stock purchased by you will be deposited with me as collateral for the loan, which is to run to January 10, 1958, at which time we will work out the details necessary to bring about the results required under our arrangements calling for a 50-50 division of benefits resulting from outside activities.

Will you please sign the duplicate of this letter to indicate that it is in accordance with your understanding.

Sincerely yours,

JAN:G

AGREED UPON:

Benjamin Graham

Davidson Becomes Chairman of the Boards—Kreeger, Rodgers and Fries, Presidents.

BOARDS OF DIRECTORS ANNOUNCE 19 PROMOTIONS

Lorimer A. Davidson, formerly President and Chief Executive Officer of our five companies, was elected Chairman of the Board of the five Companies, GEICO, GELICO, GECO, GEFCO, and CRICO, at the July 22 meetings of the Boards of Directors. He continues as Chief Executive Officer of the Government Employees Companies.

Mr. Davidson, a Director of the Companies since 1952, joined GEICO as Assistant to the President in 1948. He became First Vice President in 1954, serving in that capacity until his election as President in 1958.

Born in Canada and educated at Stanstead Wesleyan College in Quebec, Mr. Davidson began his business career in Wall Street as a bond salesman, later as a broker. His career was interrupted by six years of service as an officer in the Royal Canadian Artillery, Canadian Army during World War II. After the war he was Washington representative of Eastman Dillon, Union Securities & Co., until he joined GEICO.

In 1927 Mr. Davidson married Miss Betty Gael Valentine of Rosedale, Long Island. Both Mr. and Mrs. Davidson are members of St. Alban's Episcopal Church in Washington, where Mr. Davidson serves as a vestryman. The Davidsons have one son, Thomas F. Davidson, II, now Manager of Advanced Systems, Thiokol Chemical Company, Ogden, Utah, and three grandchildren, Thomas F. Davidson, III; Richard Alan Davidson, and Gwyn Ann Davidson.

Jerome A. Newman, who resigned as Chairman of the Board after more than six years of service in that capacity, continues to serve on the Boards of Directors and as Chairman of the Investment and Compensation Committees. He is also a member of the Executive Committee.

Continued

L. A. Davidson

Jerome A. Newman

3

JUL 9 1877 Alexander Graham Bell and three partners form the Bell Telephone Company and issue 5,000 shares of stock.

JUL 25 1893 The Panic of 1893 reaches its low point; with nearly one-quarter of the nation's railroads heading into bankruptcy, the directors of the NYSE almost close down the exchange.

Charles Dickens on Compound Interest

London. Michaelmas Term lately over, and the Lord Chancellor sitting in Lincoln's Inn Hall. Implacable November weather. As much mud in the streets as if the waters had but newly retired from the face of the earth, and it would not be wonderful to meet a Megalosaurus, 40 feet long or so, waddling like an elephantine lizard up Holborn Hill. Smoke lowering down from chimney-pots, making a soft black drizzle, with flakes of soot in it as big as full-grown snowflakes — gone into mourning, one might imagine, for the death of the sun. Dogs, undistinguishable in mire. Horses, scarcely better; splashed to their very blinkers. Foot passengers, jostling one another's umbrellas in a general infection of ill-temper, and losing their foot-hold at street-corners, where tens of thousands of other foot passengers have been slipping and sliding since the day broke (if the day ever broke), adding new deposits to the crust upon crust of mud, sticking at those points tenaciously to the pavement, and accumulating at compound interest.

— Bleak House (1852–53)

By Brian Grinder and Dan Cooper

As I (Brian) read the opening paragraph of *Bleak House* by Charles Dickens, I was struck by his unusual use of "compound interest" as a description of how mud accumulates on the streets of London. In introductory finance texts, compound interest is often described as the "ninth wonder of the world" (Cornett, Adair and Nofsinger), not as an accumulation of mud. According to Dickens biographer Claire Tomalin, "Dickens makes this the most powerful beginning of all his novels as he rolls out the dark, dirty English earth and sky to set the theme of the book." And there in the mud lies compound interest. What is it about compound interest that made Dickens use the term in such a derogatory way?

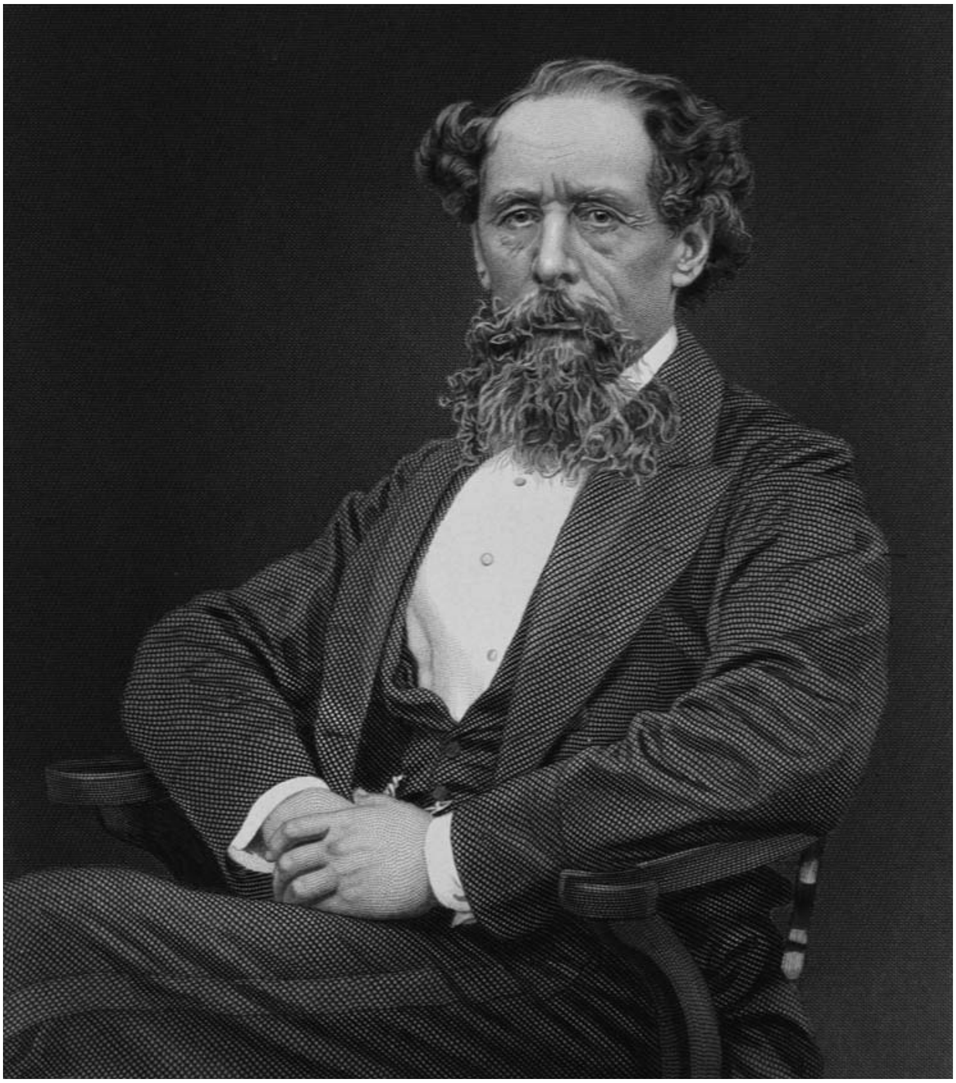
In 1824, Dickens's father, John, was arrested and thrown into the Marshalsea debtors' prison for failing to pay a local baker £40. Although this incident is well-known today, it was a "sad and shameful secret" that Dickens usually kept to himself during his lifetime. The 12-year-old Dickens was forced to quit school and go to work at a boot blacking factory. The embarrassment of his father's imprisonment and his own humiliation at having to quit school and work at a mindless factory job had a profound influence on the rest of his life.

Dickens later wrote of the Marshalsea prison in his novel *Little Dorrit (1855–57)*. In the novel, he describes a prisoner in the facility who bears a striking resemblance to his father. In the passage below, note how the term "compound interest" is used to describe the prisoner's increasing confusion over the financial situation that landed him in debtors' prison:

> The affairs of this debtor were perplexed by a partnership, of which he knew no more than that he had invested money in it; by legal matters of assignment and settlement, conveyance here and conveyance there, suspicion of unlawful preference of creditors in this direction, and of mysterious spiriting away of property in that; and as nobody on the face of the earth could be more incapable of explaining any single item in the heap of confusion than the debtor himself, nothing comprehensible could be made of his case. To question him in detail, and endeavour to reconcile his answers; to closet him with accountants and sharp practitioners, learned in the wiles of insolvency and bankruptcy; was only to put the case out at compound interest of incomprehensibility. The irresolute fingers fluttered more and more ineffectually about the trembling lip on every such occasion, and the sharpest practitioners gave him up as a hopeless job. "Out?" said the turnkey, "he'll never get out. Unless his creditors take him by the shoulders and shove him out."

Unlike the prisoner in *Little Dorrit*, luck played a role in getting John Dickens released. After more than three months in prison, Dickens's grandmother died, leaving his father an inheritance of £450. His father was free but would continue to be an embarrassment and a drain on Dickens's finances until his death in 1851.

Dickens's father wasn't the only family member to strain his finances. He had a large family which included 10 children; many of them required financial help from their father long after they had entered adulthood. Dickens's brother, Fred, was also constantly asking him for



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Author Charles Dickens references "compound interest" many times in his novels, as he was greatly affected by his family's financial troubles.

financial assistance. His financial situation became even more dire when he separated from his wife and began supporting his mistress and her family. Compound interest to the financially distressed is more of a problem than a wonder.

The financial turning point for Dickens came with the publication of *Dombey and Son* in 1846-1848. Tomalin tells us that Dickens earned £3,800 in 1847, "and for the first time ever he had enough money in the bank to be able to invest." It's ironic that a novel that points out how powerless money is when it comes to saving life, gaining health or attaining love would serve as a turning point for Dickens's financial situation. Dickens cemented his fortune during the last years of his life by giving professional readings of his own works. These readings in Great Britain and the United States garnered over £40,000 for Dickens, which was almost half of his entire estate.

In spite of a turn in his financial fortunes, Dickens's attitude towards compound interest didn't change much. In *Bleak House,* for instance, Dickens makes one of his more memorable uses of compound interest by identifying it as the god of a family of moneylenders:

> The father of this pleasant grandfather, of the neighbourhood of Mount Pleasant, was a horny-skinned, two-legged, money-getting species of spider who spun webs to catch unwary flies and retired into holes until they were entrapped. The name of this old pagan's god was Compound Interest. He lived for it, married it, died of it.

In an *Uncommercial Traveller* essay for the journal *All The Year Round* entitled "Night Walks" (1860), Dickens describes dry rot in wood and in men advancing "at a compound usury quite incalculable." In another of these essays, entitled "Bound for the Great Salt Lake" (1863), he describes the children of Mormon emigrants boarding a ship in London on the first stage of their journey to Utah as an "accumulated compound interest of children."

Dickens saw compound interest as a force that eventually caused rapid, out of control growth wherever it was applied, whether it was the children of Mormon emigrants or Miss Tox's memory of Joe Bagstock in *Dombey and Son:*

> And yet, Miss Tox, as it appeared forgot him—gradually forgot him. She began to forget him up to the time of the christening. She went on forgetting him with compound interest after that.

The geometric growth of money achieved with compound interest was first described by the mathematician Robert Price, who in 1772 wrote, "Money bearing compound interest increases at first slowly. But, the rate of increase being continually accelerated, it becomes in some time so rapid, as to mock all the powers of the imagination." Price then described how a single penny invested at 5% compound interest at the birth of Jesus would have been worth more than 150 million Earths of solid gold in Price's day.

Thomas Malthus would later take this concept and apply it to population growth. In *An Essay on the Principle of Population* (1798), Malthus argued that while the population was growing geometrically at compound rates, the food supply was only growing linearly. Eventually population growth would outstrip the food supply and cause mass starvation. The Utilitarian philosophers who built on Malthus's work argued that the government should do nothing to help the poor because it would

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Scene from *Bleak House*, in which Dickens references "compound interest" in the opening paragraph.

only increase the surplus population and hasten the coming catastrophe. Dickens, however, was adamantly opposed to government policies towards the poor that were inspired by Utilitarian ideas and fought against them his entire life.

Compound interest left a bad taste in Dickens's mouth because of the struggles he experienced with his personal finances and because of its association with misguided laws that only intensified the plight of the poor. Even when he was in a position to benefit from compound interest, he continued to view it as a plague on mankind. **$**

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All the Presidents' Bankers

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By Nomi Prins

By the end of the 19th century, the titans of banking were replacing the barons of industry as the beacons of economic supremacy in the United States. Some of the men who epitomized this transformation straddled both industry and banking. Others relied exclusively on their position within the financial arena. The shift would have a profound and irrevocable impact on America's future. New lines of power would be drawn, both within the country and beyond its borders. The modern age of financial capitalism had begun.

In this new paradigm, the White House would find itself operating in a more integrated manner with the most powerful bankers. On the way to that eventuality, President Theodore Roosevelt and the nation's top financier, J.P. Morgan, would engage in a battle of wills and egos to stake their respective claims.

Though the 20th century would be dubbed "The American Century" — reflecting the nation's political and economic dominance, marked by the two-decade-long Progressive Era of social reforms and constitutional amendments — its early years also unleashed an epoch of enhanced political-financial alliances between Washington and Wall Street. Co-dependencies and tensions between the two spheres of authority would define not only the nation's domestic agenda, but also its identity as an emerging financial and global superpower.

The domestic power game emanated from the railways, an industry cultivated by the country's richest barons. Though railroad companies constituted the majority of issues on stock and bond markets, industrial companies like US Steel, International Harvester and General Electric were gaining ground. Meanwhile, the banking sector was evolving from a business predicated on lending for production and expansion purposes to one predicated on the consolidation, distribution and packaging of capital for its own sake. As making money became more important than making products, control of America's direction shifted to a smaller group of elite financiers.

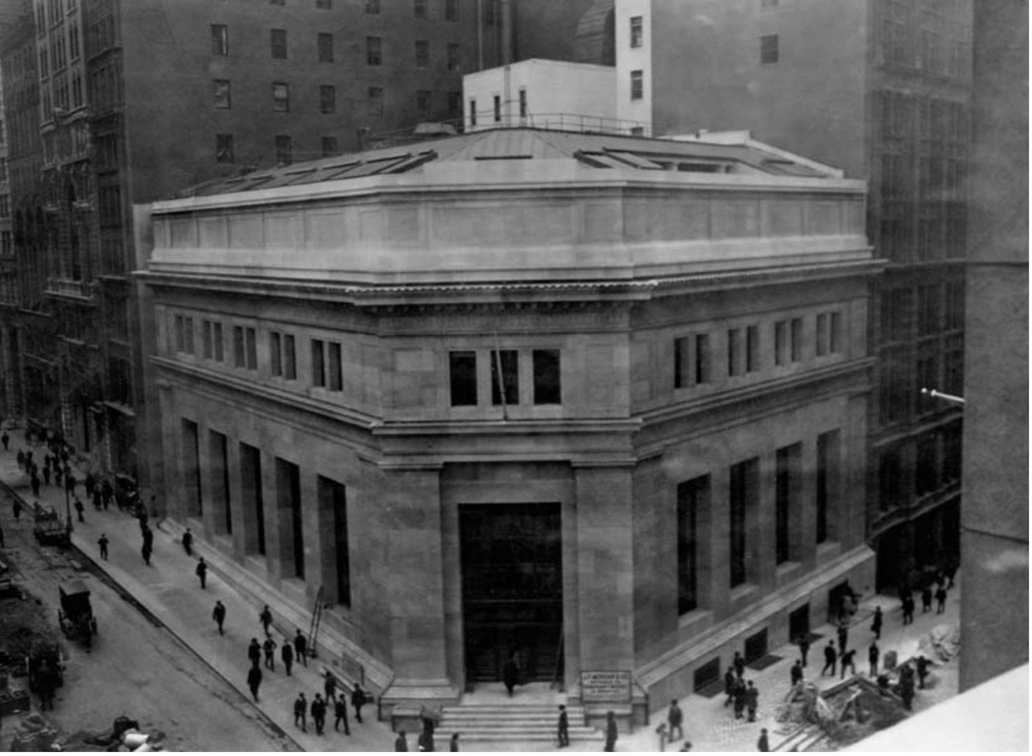
These early 20th-century bankers were not simply focused on creating wealth, either; they were also interested in manufacturing "influence capital." The manner in which they dictated the behavior of money rivaled the way the government directed the country. Late 1890s economic crises had revealed that the Morgan Bank (J.P. Morgan & Company) held more money and gold than the Treasury Department. As the need for money became more critical, the men who controlled that money became that much more powerful. (Today, the Morgan Bank is a component of JPMorgan Chase, the nation's largest bank.)

Morgan controlled nearly 70% of the steel industry — following the creation of US Steel in 1901 — and at least one-fifth of all corporations trading on the New York Stock Exchange. His power intensified when the railroad industry began to crumble under the weight of too much speculation at the turn of the 20th century. Morgan swept in to break up and then reconstruct the industry. In the process, he extended loans to any participants left standing. Desperate businessmen eagerly accepted his harsh terms.

Another major financial player was billionaire John D. Rockefeller. From 1886 to 1899, annual profits in Rockefeller's Standard Oil Company, one of the world's preeminent industrial companies, tripled from $15 million to $45 million. The influx of cash required a place from which to spawn greater wealth, and the very seeking of such capital catapulted its accumulators to greater levels of influence.

In conjunction with James Stillman, the formidable president of the National City Bank of New York, Rockefeller began investing in banks, insurance companies, copper, steel, railroads and public utilities. The Stillman-Rockefeller alliance ensured that "the City Bank" became known as the "Standard Oil bank." Solidifying the business union, William's son, William Goodsell Rockefeller, married Stillman's daughter, Elsie Stillman, in 1902.

The Panic of 1893 had triggered the collapse of lesser railroads, enabling Stillman, William Rockefeller, E.H. Harriman and financier Jacob Schiff to take control of one of the largest railroad companies, Union Pacific. Whereas the notion of a railroad trust, or combination of companies, had already emerged, these men constituted one of the two burgeoning Wall Street "money trusts." Their elite group consisted of the Rockefeller family, Union Pacific, Standard Oil and the Wall Street firm of Kuhn, Loeb & Company under Schiff.



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The centers of political and financial power in the early 20th century: the White House and the House of Morgan.

The other group — or "inner group," as it would be known — was the dominant Wall Street alliance. It pivoted around Morgan and included empire builders like Great Northern Railway CEO James Hill and George Baker Sr., a prominent society man who served as head of the First National Bank. Stillman wisely chose to belong to both groups.

Within the financial sector, Morgan acted as a welder, craftily merging the greatest banks, trusts and insurance companies into a single construct. Through stock ownership and interlocking directorates, Morgan spread his control across the First National Bank, National City Bank, the Hanover Bank, the Liberty Bank and Trust, Chase National Bank and the nation's major insurance companies. Controlling the domains of investment banking and insurance, Morgan, Baker and George Perkins, head of New York Life and a Morgan partner, could easily increase their wealth. Their insurance companies bought the securities that they created as investment bankers. This circle of fabricated demand enticed outside investors to purchase their securities at higher prices. The trio then reinvested the profits as deposits, providing their banks with additional capital for similar activity.

National City Bank, First National Bank and the Morgan Bank had an agreement that "on any issue of securities originated by any one of the three, the originating house was to have 50 [percent] and each of the other two was to have 25 [percent]." In addition, these three major banks underwrote and accepted the deposits for many other non-financial businesses.

Additionally, in keeping with his distinction as the world's main global banker, Morgan's reputation in Europe helped elevate his position in America. European investors were major buyers of American stocks and bonds and coveted anything with Morgan's name on it. That support dated back to 1890, when the venerable Barings banking house nearly folded after a disastrous gamble on Argentinean bonds. While most London firms ignored its calls of distress, the Bank of England turned to Morgan to rescue Barings. The bailout fostered a lasting international relationship.

Four years later, Morgan was called upon to save the United States from bankruptcy. And in 1899, Treasury Secretary Lyman Gage was forced to borrow $50 million from Morgan Bank to purchase foreign gold to sustain the nation's financial well-being. Congress later attacked Morgan's egregious terms as being "extortionate and unpatriotic." But at the time he was considered a hero for providing them.

When Roosevelt made the unprecedented decision to use executive authority to "bust" the powerful trusts, he positioned the action as one that would help the country at large. He was not against big business per se, but he possessed a defiance on behalf of the underdog and sought to cultivate what he called a "square deal" for all Americans. He believed in the power of competition, but he believed the playing field had to be fair. He knew that as the trusts grew more powerful, the relative power of the government would decline.

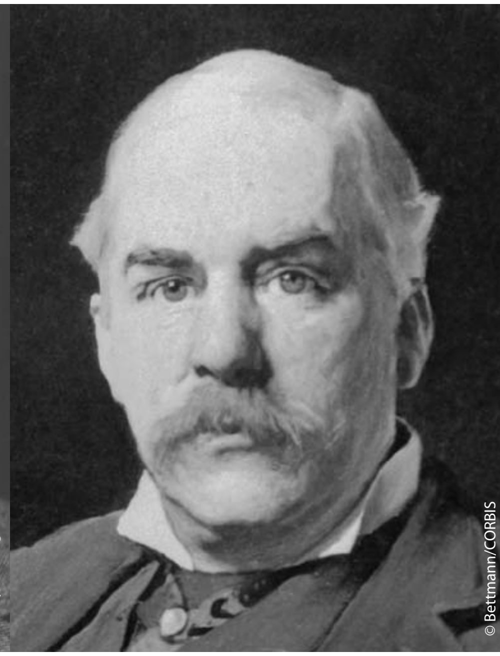
This awareness formed an integral part of Roosevelt's legacy. His trust-busting initiative began in 1902, just months after he took office following the assassination of President William McKinley. Roosevelt proved himself to be a formidable politician, attracting support from the business and working classes by positioning himself as a fighter against the "tyranny of wealth," as wielded by the grossly advantaged trust titans.

Raised in a New York mansion, well-traveled and schooled at an Ivy League university like his would-be adversary (and later ally) J.P. Morgan, Roosevelt held the pedigree of a consummate businessman. But he also possessed a rugged edge and a rebellious streak: he had worked as a rancher in the North Dakota Badlands, and some people said he had the characteristics of a lion.

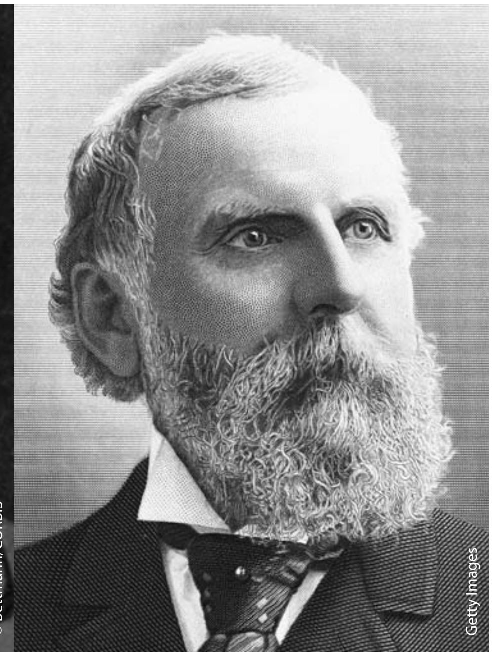
Roosevelt's use of Presidential power to take on the trusts asserted the might of Washington in this new financier-dominated era. Roosevelt directed the Justice Department to pursue an antitrust suit charging the Northern Securities Company with violating the 1890 Sherman Antitrust Act, which prohibits trusts from becoming monopolies.

Morgan, Harriman and Hill had formed Northern Securities, one of the nation's largest railroad trusts, in 1901. The President's power play might have been avoided if Morgan had less of an ego. But when Morgan approached Roosevelt privately to settle the matter, Roosevelt decided: "Mr. Morgan could not help regarding me as a big rival operator who either intended to ruin all his interests or could be induced to come to an agreement to ruin none."

President Theodore Roosevelt



Financier J.P. Morgan



Treasury Secretary Lyman Gage

Morgan was directed to break up his key trust. The Northern Securities case preceded more than 40 such lawsuits. In the process, Roosevelt gained enough popular support to win the election of 1904 with 70% of the electoral vote.

Congress was also flexing its muscles. Its members were increasingly taking bribes from the leaders of big business in return for favorable legislation. In March 1906, *Cosmopolitan* magazine shed a light on the situation by running a hard-hitting investigative series, "The Treason of the Senate," written by popular novelist David Graham Phillips. William Randolph Hearst, a US House member, had purchased the magazine in 1905 with the goal of enticing readers with juicy stories. Subscriptions doubled within two months of the articles' appearance.

Phillips exposed widespread corruption of the Senate, in particular, by the Standard Oil Company. He revealed that New York Senator Chauncey Depew had received more than $50,000 from his "70-odd" directorships of companies that wanted him to do their bidding — particularly insurance and railroad companies. Such serious conflicts of interest, though legal, were distasteful to the public.

Though Roosevelt attacked Morgan's railroad trust and spoke disparagingly of the "tyranny of wealth" and its influence over America, he was less pleased about this skeptical glare placed on Washington. He coined the pejorative term "muckrakers" to describe the new breed of investigative journalists, including Phillips; Upton Sinclair, who exposed the literal rot of the meat-packing industry; and Ida Tarbell, who focused on Standard Oil.

Most illuminating of America's future political-financial path, Phillips's article slammed Rhode Island millionaire businessman-turned-senator Nelson Aldrich for his connections with the elite. As Phillips wrote, "In 1901, his [Aldrich's] daughter married the only son and destined successor of John D. Rockefeller. Thus, the chief exploiter of the American people is closely allied by marriage with the chief schemer in the service of the exploiters." Aldrich would soon play a more significant role in America's financial capitalism era than Phillips could have imagined. Though Roosevelt had purposefully steered clear of trying to change the nation's currency or banking system, Aldrich would be intricately involved in transforming both.

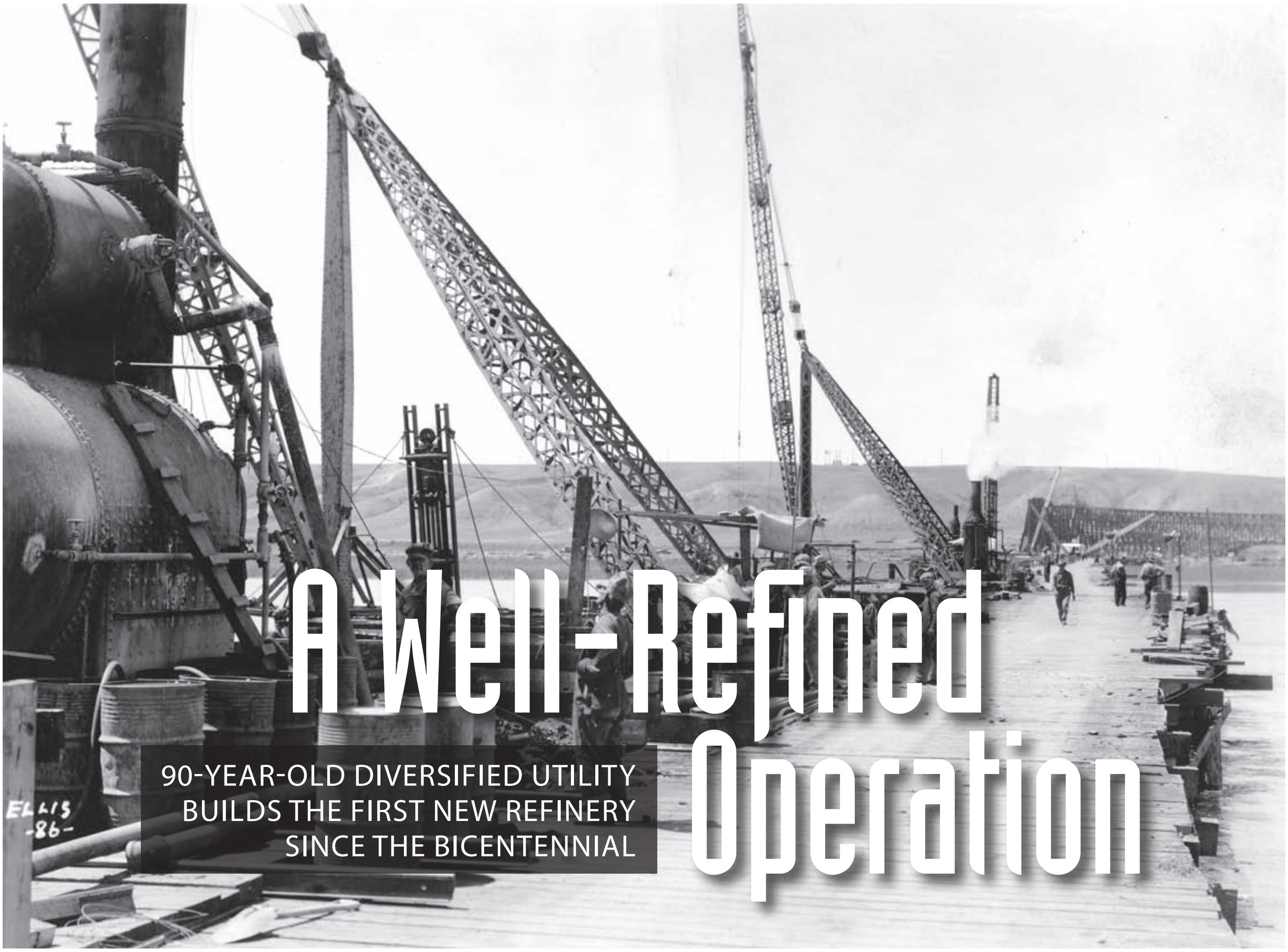
Muckrakers aside, the liberal and conservative press continued to seek out the bankers' expertise. Though there remained widespread belief in Washington and in the press that after the Panic of 1893 and subsequent depression something had to be done to avoid a situation whereby Morgan was called in to save the country again, nothing happened for years in that regard. Roosevelt had no interest in rocking that boat, particularly before the 1904 election. As such, the elite bankers generally, and Morgan in particular, increased their control over the US economy. The results proved disastrous. $

Nomi Prins is a journalist, speaker, respected TV and radio commentator and former Wall Street executive. Author of five books including Other People's Money *and* It Takes a Pillage, *her writing has been featured in* The New York Times, Fortune, Mother Jones, the Guardian, the Nation *and other publications. She is a senior fellow at Demos. Follow her on Twitter @NomiPrins.*

This article is excerpted from All the Presidents' Bankers: The Hidden Alliances that Drive American Power *by Nomi Prins (April 2014). Reprinted with permission from Nation Books.*

A Well-Refined Operation

90-YEAR-OLD DIVERSIFIED UTILITY BUILDS THE FIRST NEW REFINERY SINCE THE BICENTENNIAL



MDU Resources Group

By Gregory DL Morris

Conventional wisdom has been that it would be impossible for a wholly new oil refinery to be built in the US. The last one was put into service by Marathon Oil (now Marathon Petroleum) in Garyville, Louisiana, in 1976, and at the time was the first grassroots refinery built in a decade. Since then, regulatory and cost realities have been thought to be far too onerous for any such facility to be built from a green field. And even if those could be overcome, community resistance, to the point of litigation, would be insurmountable.

But people claiming that something cannot be done are usually interrupted by other people doing it. Sure enough, a new refinery is under construction near Dickinson, North Dakota, and is expected to be commissioned by the end of the year. Even more intriguing, the interrupter doing it is not a big oil company or a brash private equity firm. It is MDU Resources Group, a 90-year-old company once known as Montana-Dakota Utilities that today is a diversified corporation operating utilities, energy production and construction.

Strictly speaking, MDU is not a conglomerate: there are synergies among the separate operating companies and indeed they are all collaborating on the construction of the refinery. But still there is a charming small back-to-the-future irony that a conglomerate, the vogue business model of the 1970s, is building the first new refinery in the country since the '70s.

"We don't think of ourselves as a conglomerate," said MDU President and CEO David L. Goodin, "but the refinery is very much a family affair." And while he appreciates the attention the refinery project has drawn for the company, he said he feels the more important story is the history and the consistency. "We have had a conservative approach to business for 90 years," Goodin said. "That is something. And 76 years of uninterrupted dividends is a little bit of a longevity story."

The predecessor firm of MDU, the Minnesota Northern Power Co., was founded in Minneapolis in 1924 by Roland McCartney Heskett. Less than a year later, it made its first acquisition, Minnesota Electric Light & Power, in Bemidji. Heskett had built streetcar systems in Wisconsin about the same time as Samuel Insull was building a utility and transportation empire based in Chicago.

Instead of growing downstream from power to transportation, Heskett found traction upstream in hydrocarbons. In 1926 Minnesota Northern acquired land in

Missouri River Bridge at Fort Peck.

MDU Resources Group

Specimen stock certificate for the Montana-Dakota Utilities Co.

MDU Resources Group

MDU President and CEO David L. Goodin.

Montana that was prospective for natural gas. Wells were drilled and proved commercial, and Minnesota Northern formed the prosaically-named Gas Development Co. in 1927 to explore for and produce gas, and also to build pipelines to deliver the resource.

New gas fields, along with gathering and distribution lines were added, as were electric generating stations and transmission systems on the utility side. By 1930 Minnesota Northern was a holding company with operations in four states and one province. The firm survived the Great Depression, if only just. Heskett believed in a clean balance sheet and kept corporate debt to a minimum, but there were close calls on mortgage bonds.

Insull, the utility baron, worked expansively on credit, and in 1932 his empire collapsed. Many of his utilities' service territories bordered those of Minnesota Northern. The newly-elected Roosevelt administration responded to the Insull demise with the Wheeler-Rayburn bill, which became the Public Utilities Holding Company Act in 1935, and begat the Rural Electrification Administration.

Heskett opposed the Wheeler-Rayburn bill, but in response to its imminent enactment, Minnesota Northern recombined several of its operating utilities and renamed the parent corporation Montana-Dakota Utilities Co. The following year oil was added to the gas side of the business with producing wells in Montana. Through the years the company also got into and more recently out of coal mining, originally as a source of fuel for its power plants.

Post-war growth started within months of the end of hostilities. In *The Mondakonians: Energizers of the Prairie*, an illustrated history of MDU Resource Group (1992), Bill Beck writes, "In December 1945 the first power delivered from the federal government's hydroelectric [dam] at Fort Peck, Montana was delivered to MDU's transformer yard at Glendive, and the company became one of the first investor-owned utilities in the nation to wheel federally generated electricity over its transmission lines."

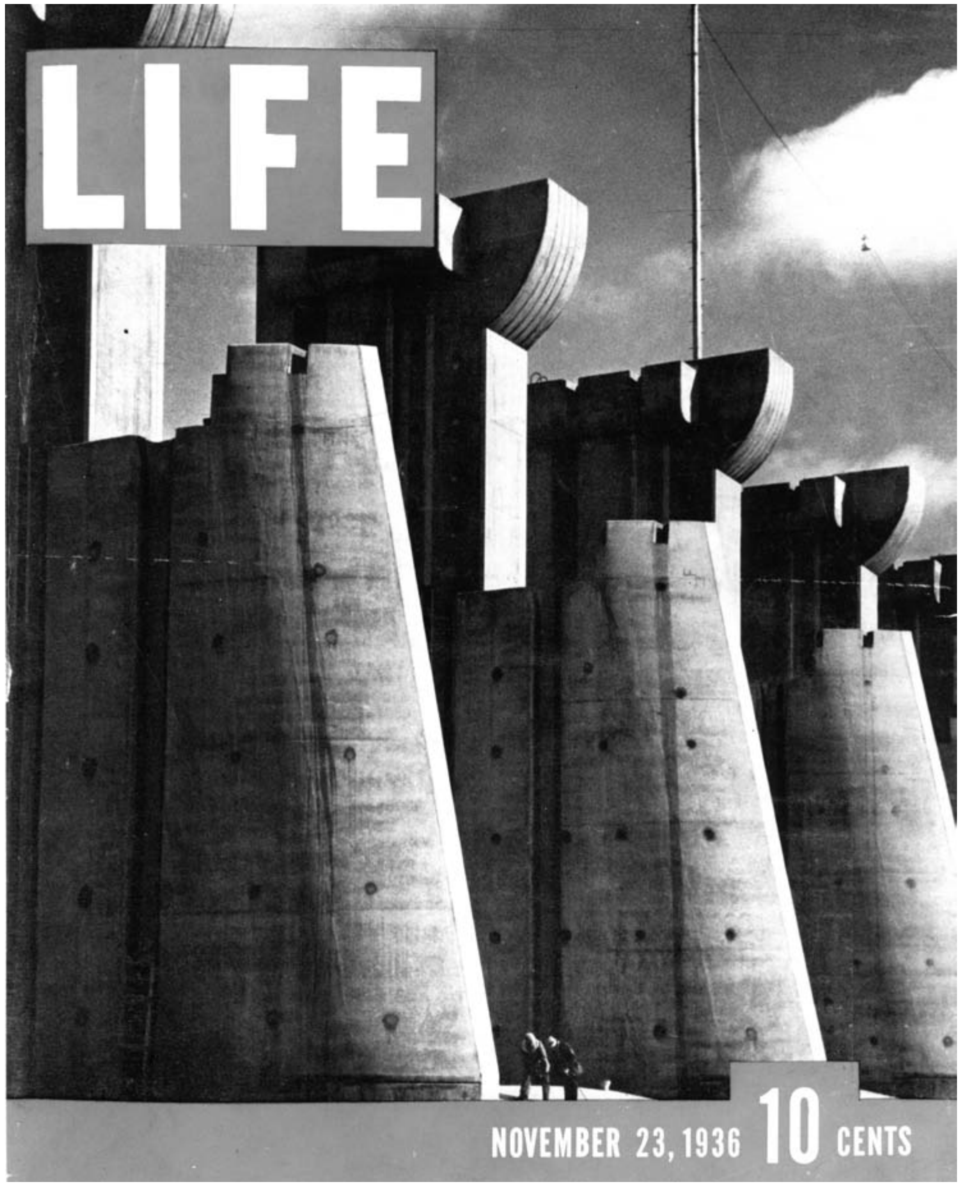
In 1948 MDU was listed on the New York Stock Exchange, and in 1968 the firm relocated to a new headquarters building in Bismarck, North Dakota. In 1985 the company changed its name to the present one as a result of the corporate rearrangement required to comply with the Natural

Gas Policy Act of 1978. That act gradually deregulated the country's natural gas utility business and mandated the separation of production and transmission companies. The change in name served the company well as it expanded into construction, materials and utility services through the 1990s.

The refinery project fits the MDU M.O. closely. "We have exploration and production in the Bakken shale [in North Dakota]," Goodin said. Bakken crude is light and sweet, so the refinery will not require complex high-temperature and high-pressure reactors. The simple design known as a topping plant basically heats the crude and separates it into fractions. It will produce diesel fuel, naphtha and a heavier component called atmospheric bottoms.

The Dakota Prairie Refinery is a $300 million joint project with Calumet Specialty Products, a lubricants company. It will have an initial crude capacity of 20,000 barrels per day of diesel fuel at its topping plant 100 miles due west from Bismarck, and just east of Theodore Roosevelt National Park, site of the cattle ranch he owned and operated long before becoming President.

Knife River Corp., MDU Resources' construction materials and contracting subsidiary, has moved approximately one million cubic yards of material since construction began in March 2013. "We are focused on constructing the facility on time and on budget and continue to target an in-service date in late 2014," said Goodin. "This project is a strong organic growth opportunity for us and, based on our assumptions, we expect it will generate EBITDA of $70 million to $90 million in year one, to be shared equally with Calumet."



MDU Resources Group

The first issue of *Life* magazine featured a cover photo of the Fort Peck Dam.

In addition to Knife River, other MDU Resources companies involved in the project include Fidelity Exploration & Production, which will supply crude oil to the facility; WBI Energy, which will supply natural gas service to operate the facility; and Montana-Dakota Utilities, which will supply the facility's electricity needs.

The primary product will be diesel fuel. "The state uses 55,000 barrels a day of diesel," said Goodin, "and the one other refinery in the state produces about 18,000 barrels a day, so there is a 32,000-barrel-a-day shortfall. We will be producing up to 7,000 barrels a day of diesel, so there is still room for more."

Given the size of the market, there was a temptation to plan a bigger refinery, but true to form, MDU stuck to a practical point of departure. "The size is appropriate for emissions permitting, and also speed to market," said Goodin. "We have planned and are on schedule for a 20-month construction calendar. The focus is not on meeting all the diesel needs; the focus is on being up and running, getting the first-move advantage."

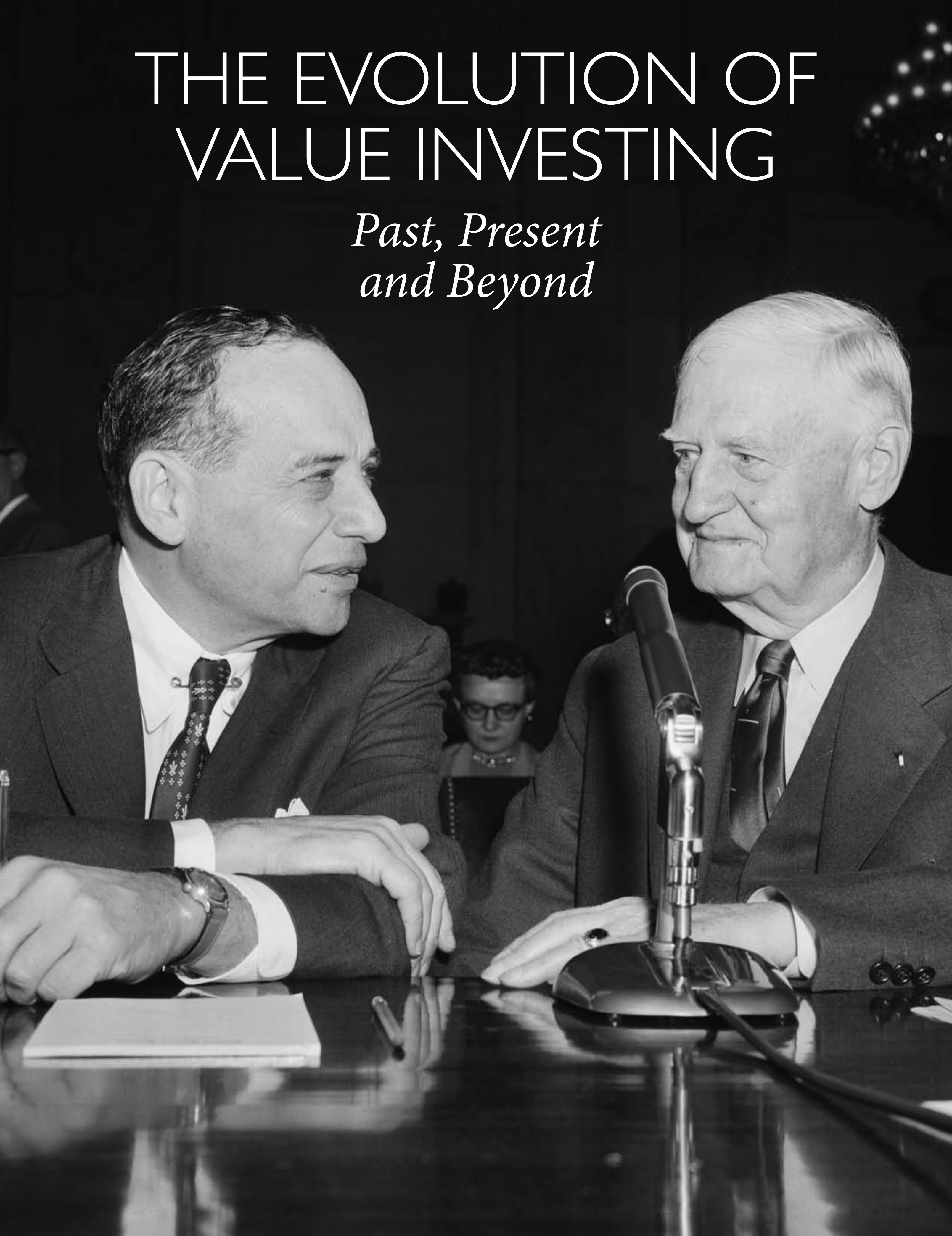
The middle fraction, naphtha, is likely to move to Canada as a diluent for heavy oil. At present, diluent is moved from refineries all over the country to Canada, primarily by rail. That gives MDU a competitive advantage on shipment times and costs. The heavy fraction will be shipped to Calumet's processing facility at Superior, Wisconsin, where it will be used to make lubricants and specialty consumer formulations.

The refinery and its collaborative construction among the subsidiary groups then becomes a model for other such facilities. "The project team has gotten quite a bit visibility to the outside world as a result of the project. We know that we have a lot of outside interests watching. Our construction group is licensed in 43 states." $

Gregory DL Morris is an independent business journalist based in New York. He is principal and editorial director of Enterprise & Industry Historical Research, and is an active member of the Museum's editorial board. He can be contacted at gdlm@enterpriseandindustry.com.

THE EVOLUTION OF VALUE INVESTING

Past, Present and Beyond



Benjamin Graham (left) with General Robert E. Wood, 1955.

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By Joseph Calandro, Jr.
and Frederick J. Sheehan

Considering the popularity of value investing, it is somewhat surprising that a paper recently published by Joseph Calandro in the *Journal of Investing* was the first formal attempt to categorize the development of this highly-effective and influential school of thought over time. The following article summarizes this categorization of value investing's past and present and offers suggestions on what its future may hold.

Founding Era: 1934 to 1973

The "official" founding of value investing can be dated to 1934 with the publication of Benjamin Graham and David Dodd's seminal book, *Security Analysis*. The strategic concept upon which value investing was founded is as insightful as it is simple; namely, that assets purchased at prices for less than their liquidation value (estimated as current assets less total liabilities or "net-net value") provide an opportunistic and relatively low risk form of investment (where *risk* is defined as the possibility of loss) due to the "margin of safety" afforded by the discount from liquidation value.

Over time, some investors would come to base margins of safety off of earnings power and even growth value in addition to the balance sheet. Exhibit 1, taken from Professor Bruce Greenwald's popular book *Value Investing: From Graham to Buffett and Beyond*, profiles the different approaches of modern value investing, as well as some of the professionals associated with each approach as of the book's publication.

The cornerstone of value investing has always been, and will always remain, firmly grounded in the margin of safety principle, regardless of how any specific margin may be estimated. The Founding Era effectively ends with the publication of the 1973 edition of Graham's immensely popular book, *The Intelligent Investor,* which distills lessons from *Security Analysis* to a non-professional audience. Shortly after the book's publication, in 1976, Graham passed away at the age of 82.

Post-Graham Era: 1973 to 1991

The start of the Post-Graham Era coincides with the great 1973–74 bear market which, amongst other things, presented numerous investment opportunities akin to those

Exhibit 1: Approaches to Value Investing

CLASSIC	MIXED	CONTEMPORARY
Graham	**Gabelli**	**Buffett**
Tweedy, Browne	**Neff**	**Greenberg**
Schloss & Schloss	***Price***	***Ruane, Cuniff***
Heine	Royce	
Heilbrunn	Greenblatt	
Klarman	Whitman	
Sonkin		
Diversified portfolio	Replacement value	Concentrated portfolio
Tangible assets	Sufficient research	Intense research
Cursory research	Private market value	Franchise value
Unpresentable	Catalyst	Attractive but not sexy
"Wounded ducks"	Relative value	Owning the business
In the shadows	Bland	"Wounded eagles"
	Normalized earnings	Hiding in plain site
	Temporarily offstage	

Source: Bruce Greenwald, et al., *Value Investing: From Graham to Buffett and Beyond* (NY: Wiley, 2001), p. 159.

seen at the beginning of the Founding Era. Therefore, it was not coincidental that such a market environment saw the ascendancy of a number of highly-successful value investors such as Gary Brinson, Jeremy Grantham, John Neff and others.

Nevertheless, it was during this period that modern financial economic theories were beginning to take hold. In his bestselling book, *Capital Ideas,* Peter Bernstein summarized these theories, all of which tend to find disfavor with professional value investors. For example:

- Economists believe that markets are "efficient," while value investors know that, at times, markets can behave extremely inefficiently;
- Economists believe that capital structure is "irrelevant," while value investors know that capital structure is *always* relevant (for example, a company financed with 100% debt is quite different from one financed with 100% equity);
- Economists believe that investments should be guided by modern portfolio theory and asset pricing models, while value investors understand, and carefully exploit, the fact that volatility and statistical measures of it are *not* risk; and
- The option pricing models of financial economics do not consider underlying value; conversely, to a value investor, value is a component of option pricing just like it is a pricing component for every other economic good.

Despite the success of professional value investors during this era, the challenge for the school's theorists and practitioners was to determine how the basic insights of value investing could be reinterpreted for modern investors, and to demonstrate the significance of that reinterpretation given the market conditions investors were wrestling with.

Modern Era: 1991 to Present

To address the above challenge, value investor Seth A. Klarman, co-founder and president of The Baupost Group, picked up where Graham left off. The 20th and final chapter of *The Intelligent Investor* is titled, "'Margin of Safety' as the Central Concept of Investment," while the title of Klarman's 1991 book is *Margin of Safety: Risk-Averse Value Investing Strategies for the Thoughtful Investor.* The lucidity of Klarman's book, coupled with his investing track record, set the tone for the Modern Era of value investing.

Support for this position can be found in the influence that *Margin of Safety* has had on all of the prominent value investing books that were published after it, from Bruce Greenwald's aforementioned book (chapter 13 of which profiles Klarman), to the sixth edition of *Security Analysis* (for which Klarman served as lead editor) to Howard Marks's recently-published value investing book, *The Most Important Thing Illuminated* (which was endorsed by, and contains annotations from, Klarman).

One of the strengths of modern value investing theory is that it can be applied to all forms of investments, not just stocks and bonds. For example, consider derivatives. Bestselling books, like Michael Lewis's *The Big Short,* demonstrate that a number of investors really did "catch" the recent financial crisis by purchasing credit default swaps (CDS) at margin of safety-consistent prices prior to the crisis. Significantly, one of those investors was Klarman. How did the investors do it?

While the specifics of their investments are not publicly available, there is a real-time record of similar investments in the influential and long-running value investing newsletter, *Grant's Interest Rate Observer*, published by investor/historian/financial analyst/journalist James Grant. A compendium of Grant's newsletters leading up to "the big short" was published in a bestselling book titled *Mr. Market Miscalculates* (Mr. Market being Graham's euphemism for the short-term-oriented trading environment that dominates the financial markets). On page 171 of the book, which was taken from the September 8, 2006 edition of *Grant's Interest Rate Observer*, it was noted that a hedge fund was "expressing a bearish view on housing in the CDS market by buying protection on the weaker tranches of at risk mortgage structures. At the cost of $14.25 million a year, the fund has exposure to $750 million face amount of mortgage debt."

To see how margin of safety-rich this investment was at the time, consider the following: one way that commercial insurance companies evaluate risk pricing is to divide the premium of risk transfer (in this case, $14.25 million) by the amount of risk being transferred (in this case, $750 million), which here gives a "rate on line" of $0.014. By comparison, it is not uncommon for many businesses to pay $40,000 or more per year for $1 million of general liability insurance, which equates to a "rate on line" of $0.04.

Post-Modern Era

With value investing being applied to so many asset classes — stocks, bonds, real estate, derivatives, etc. — what could a "Post-Modern Era" possibly entail? The future could witness the application of core value investing principles, especially the margin of safety principle, to corporate management.

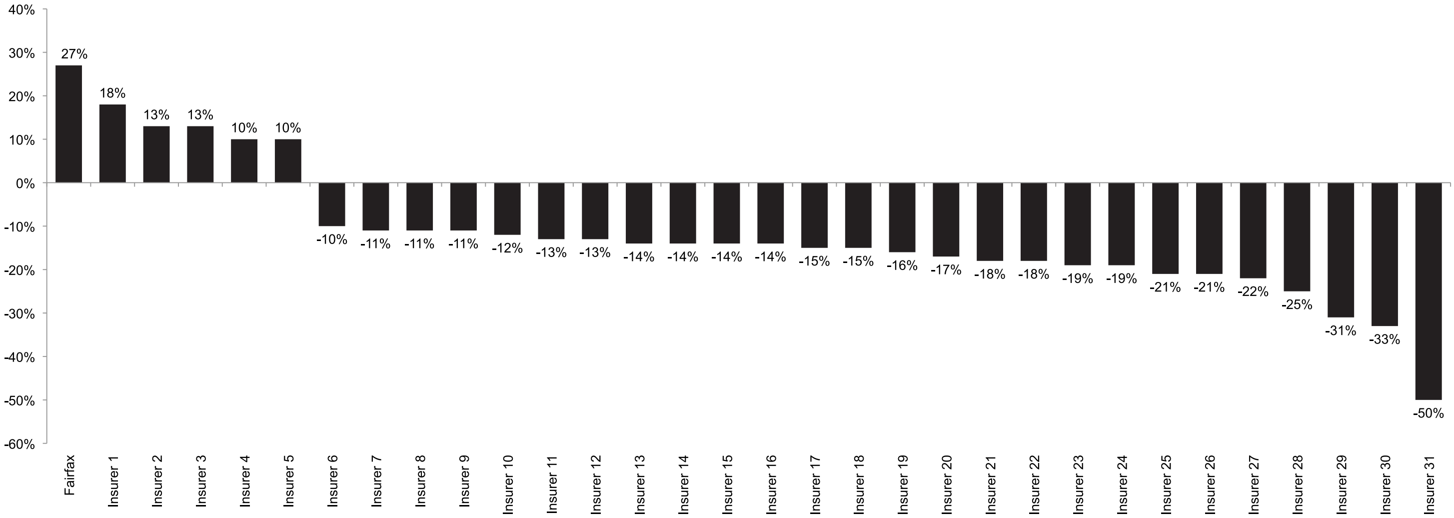
Throughout their history, value investors have been skeptical of corporate managers. For example, in *Security Analysis,* Graham and Dodd observed that "It is nearly always true that the management is in the best position to judge which policies are most efficient. But it does not follow that it will always either recognize or adopt the course most beneficial to the shareholders. It may err grievously through incompetence." In modern times, this can be seen in many corporate risk management activities.

Since the recent financial crisis, many government regulators have focused on enacting a wide variety of controls, conducting "stress tests" and ensuring that highly-leveraged firms have enough capital on hand to satisfy their liabilities. Therefore, a great deal of corporate risk management activity is undertaken to ensure compliance with various governmental mandates. Unfortunately, much of this activity involves simply documenting what firms are already doing to manage risk, which in some cases may not be very effective given the condition of certain corporate balance sheets. Therefore, it makes a great deal of intuitive sense to "stress test" those balance sheets.

Regardless of its intuitive appeal, many stress tests are informed by Value-at-Risk models, and their "economic capital" outputs, even though it is well-known that these models are thin-tailed and thus "at risk" of underestimating actual stressful market environments.

Furthermore, once a government entity specifies either a risk mandate and/or capital standard it tends to become *the* market standard. An unintended consequence of this is that firms seen to comply with governmental standards often begin to incrementally expand their risk appetites in manners frequently deemed *de facto* appropriate given

Exhibit 2: Margin of Safety-based Hedging



Source: Dowling & Partners, *IBNR Weekly #39,* October 5, 2007, p. 8. The names of the remaining 31 insurers are available from Dowling.

the compliant status of the firms in question, regardless of the effect that expansion has on their risk profiles over time.

To make matters worse, the above considerations often interact, thereby magnifying potential losses. Consider the case of Enron, whose "quants" pegged the amount the firm could expect to profit from or lose at $66 million in a single day, within a 95% probability. According to Frank Partnoy, author of *Infectious Greed*, "Enron's VAR measure was based on the inordinately smoothed profits its traders reported; in reality, the volatility of its trading range was much greater [than $66 million]. In fact, traders frequently made and lost more than their reported VAR; on a single day during 2000, traders made more than $500 million. On December 12, 2000, they lost $550 million." Such dynamics obviously magnified Enron's risk profile prior to its historic failure.

In light of the above, is it any wonder why Graham and Dodd generally felt the way they did about corporate managers? Fortunately, not all firms are managed the same way. Consider, for example, the case of value investor Prem Watsa, the founder, chairman and CEO of Fairfax Financial Holdings. Prior to the recent financial crisis, Watsa also purchased economically priced CDS, and those purchases reportedly generated a gain of more than $2 billion against an investment of $341 million. While the specifics of Watsa's position are not publicly known, one can surmise that because he is a corporate manager, the CDS he purchased were appropriate for the balance sheet he was managing, which is to say hedging.

In general, there are three ways to manage the risk of a significant balance sheet concentration: (1) reduce it, (2) diversify it or (3) hedge it. Each of these alternatives can be informed by value investing in general and by the margin of safety principle in particular. In the case of hedging, the result of Watsa's hedge speaks for itself: Exhibit 2 profiles 10% or greater changes in property and casualty insurance company performance in the third quarter of 2007. The financial performance of Fairfax Financial Holdings — shown at the extreme left of the exhibit — is materially greater than the rest of the insurance industry.

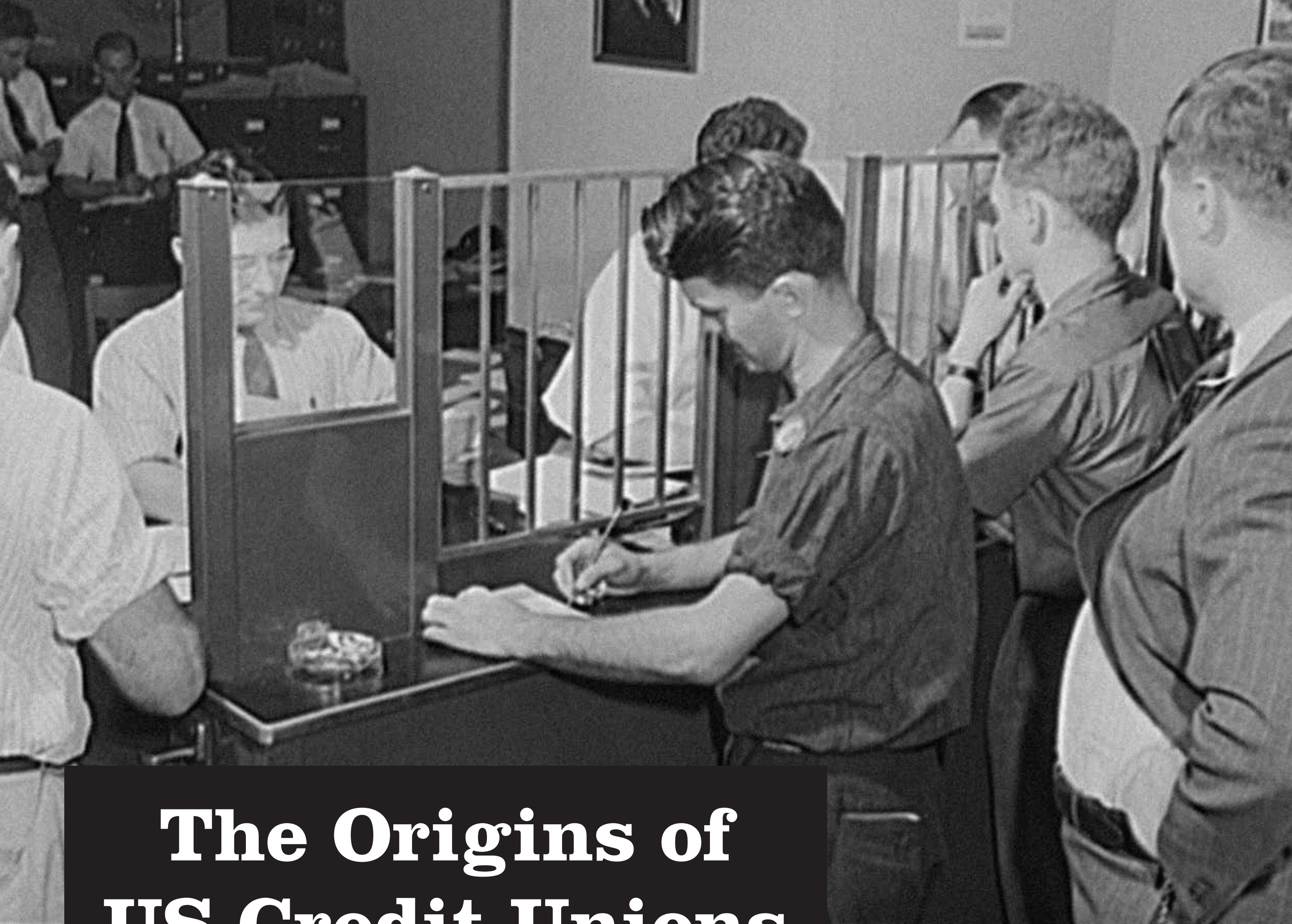
For another example of how to apply value investing to corporate management, consider mergers and acquisitions (M&A). It is well-known that many corporate M&A deals fail to create the value expected at the time they were announced. It is also well-known that the primary reason for these failures is that the transactions occur at price levels that are simply too high; in other words, the deals do not contain a margin of safety. Given the nature of private market values and the control premiums contained therein, many executives apparently believe that value investing principles cannot be applied to M&A. One can, of course, cite examples of Warren Buffett's various acquisitions here, but Buffett is primarily an investor. Fortunately, there are corporate management-specific examples as well.

First and foremost, consider the case of the late Henry Singleton, Ph.D., who was the founder, chairman and CEO of Teledyne Corporation. According to investment advisor and author John Train, "Buffett considers that Henry Singleton of Teledyne has the best operating and capital deployment record in American business." Leon G. Cooperman, the founder, chairman and CEO of Omega Advisors, was both an investor in Teledyne and a student of Dr. Singleton's strategies and management practices for decades, which he insightfully summarized in a seminal study that was presented to the New York Society of Security Analysts in 2012.

Consider also the case of the late Larry Tisch, who was the co-founder, chairman and CEO of Lowes Corporation. As Christopher Winans reflects in his aptly-titled book, *The King of Cash,* Tisch and his brother Bob founded, built and managed their highly-successful company in a margin of safety-oriented manner, especially with respect to M&A and cash management.

To understand how value investing can practically be applied to corporate M&A, consider that because its valuations are built from the bottom-up, all value investing assumptions are completely transparent. As a result, assumptions requiring clarification are natural candidates for formal due diligence. Additionally, the M&A information generated from the value investing process can be compared with the known drivers of value realization risk to determine if a deal's private market value offers a margin of safety even considering its control premium.

» *continued on page 36*



The Origins of US Credit Unions

By Matthew Cropp

On April 6, 1897, a Conservative member of the Canadian Parliament named Michael Quinn introduced a bill to ban "usurious" lending practices from the Dominion. Though the proposed legislation ultimately died in the Senate, the stories that were told over the course of the debate of people of modest means paying thousands of percent interest on small loans had a profound impact on one of the men responsible for recording it, Alphonse Desjardins.

Desjardins, the French language stenographer for the House of Commons, had previously worked as a newspaperman and was well-acquainted with many of the economic and social strains that poor and working class people were experiencing during that period's transition from an agrarian-rural to an industrial-urban economy. Inspired by the debate to delve into research on solutions for the problem of credit for people of modest means, Desjardins came upon the book *People's Banks* by the prolific British co-operator Henry Wolff.

Wolff's book provided Desjardins with an overview of the structure and experiences of several different models of cooperative finance that had been implemented in Europe over the previous half century, and he supplemented that understanding by striking up a voluminous correspondence with a number of European cooperative leaders.

As a result of the insights gleaned from this dialog, Desjardins presented the idea of establishing such an institution in his home town of Levis to a group of friends on September 20, 1900. It was received enthusiastically, and they formed a study group that met twice a week to work on the project. The completed bylaws were adopted on December 6, and *La Caisse Populaire de Levis* opened for business in Desjardins' home on January 23, 1901. Total deposits stood at $26.40 by the end of the day, and, at the beginning of May, membership had swollen to 840 and the *caisse* had granted more than $8,000 in loans.

The structure that Desjardins settled on for the *caisse populaire* drew heavily on the European experience, with a few important modifications. The earliest manifestations of the credit union idea can be traced back to the mid-19th century work of Hermann Schulze-Delitzsch and

Wilhelm Raiffeisen, the respective founders of the German urban and rural credit union movements. Recognizing that character and reputation were often people of modest means' most valuable assets, the fundamental role of their early credit unions was to allow members to leverage their character into financial credit.

To accomplish this, Desjardins incorporated several principles into the *caisse populaire*. The first was democratic member ownership, which served to replace an oppositional relationship between the borrower and the lending institution such that, should a borrower default, he would be defaulting to "us," not "them." This dynamic was reinforced by the second principle: the narrow "common bond." Not just anyone could join a credit union; rather, it was recognized that members should share a common community. By doing so, the credit union's credit committee would have social knowledge of the nature of the financial position of prospective borrowers, and borrowers would know that, if they defaulted on their debts for reasons perceived to be illegitimate, they might face social as well as financial consequences. Given the enormously influential role played by the Catholic Church in the social life of Francophone Quebec at the time, Desjardins chose the parish as the common bond of *caisse populaire*.

Credit Union and Hospital Trust building, Newport, RI.

One key area in which Desjardins deviated from the German model was in terms of liability. Both Raiffeisen and Schulze-Delitzsch had been strong advocates of unlimited liability as a way of ensuring that members took their governance responsibilities seriously. As Schulze-Delitzsch put it, "your collective liability will require you to choose your associates carefully, and to insist that they maintain regular, sober and industrious habits, making them worthy of credit." However, Desjardins was concerned that the idea of unlimited liability would be a non-starter in the Canadian context, and so the liability of *caisse populaire* members was limited to their deposits in the institution.

However, while the members' liability was limited, Desjardins was concerned that his own might not be. At the time, no legal framework existed in Canada under which such a cooperative financial institution might be incorporated, so the *Caisse Populaire de Levis* tenuously based its standing in common law. However, Desjardins was concerned that, should a disaster strike, such a justification might not stand up in court, leaving him personally responsible for making up the losses of depositors. To remedy the situation, he and his allies worked diligently to secure the passage of enabling legislation and met with success in 1906, when the Quebec Parliament unanimously passed the Quebec Syndicates Act.

While three additional *caisses* had been founded in the meantime despite the legal murkiness, organizing took off once the legal uncertainty was resolved. In 1907, three new *caisses* were established in Quebec, and, by the end of 1908, 17 were active in the province.

Such successes caught the attention of Massachusetts Banking Commissioner Pierre Jay, a fellow reader of Wolff's *People's Banks*. Jay and Desjardins began a correspondence in the spring of 1907, and Jay travelled to Ottawa in July of 1908 to visit Desjardins (who, in addition to his organizing work, was still the French stenographer for the House of Commons). Their meeting was a success, and Jay wrote to him shortly thereafter that "it had determined me to go ahead and try to bring these banks to notice in the United States — a thing I have had in mind for a long time, but have hitherto felt a bit uncertain about." His opportunity to commence that work in earnest came that November, when Desjardins embarked on a trip through New England.

Beginning in the 1880s, the increasing globalization of agricultural markets undermined the viability of much of Quebec's agricultural economy, which in turn led to a wave of French Canadian immigrants moving to New England milltowns in search of factory work. French ethnic enclaves, complete with francophone Catholic parishes, formed in many such towns, and Desjardins visited some of them on his way south from Quebec. On November 22, he stopped at St. Mary's Parish in Manchester, New Hampshire and helped establish St. Mary's Bank, which is now recognized as the first credit union in the United States.

Desjardins then proceeded to Boston, where Jay arranged for a private gathering with a number of the city's leading figures. Following this meeting, Desjardins was invited to return in February to address the Twentieth Century Club about the credit union model. In the intervening months, Jay started working towards the passage of credit union enabling legislation for Massachusetts, and he arranged to have Desjardins testify in its favor before the Committee on Banks and Banking the day prior to his scheduled speech. Both went over well, and the Massachusetts Credit Union Act became law on April 15, 1909.

In the years immediately following the passage of the Massachusetts Act, the American credit union movement grew in fits and starts. Sporadic organization of *caisses populaires* continued in francophone parishes across New England, and in 1911 the Boston Chamber of Commerce devoted some effort to credit union promotion by sponsoring an address by Desjardins to curious employers from around the state. It also formed a committee tasked with assisting in the organization of credit unions. These efforts met with moderate success, and by 1913 Massachusetts boasted 34 credit unions with combined assets of $180,923.

In the meantime, Jay had ended his tenure as Massachusetts Banking Commissioner

to become vice president of the Bank of the Manhattan Company in New York City. This career change had dampened none of his enthusiasm for credit unionism, and in 1912 he was approached by a representative of the Russell Sage Foundation, which had begun work in 1909 to develop and promote solutions to "the almost unexplored field of hardships suffered by persons of small means when they needed a small loan." Jay suggested the foundation connect with Desjardins, and a strong working relationship developed, with Desjardins helping to draft the New York credit union bill that became law in May 1913. The following year, the foundation published a short book by Desjardins entitled *The Cooperative People's Bank*. Though no immediate follow-up organizing efforts were undertaken, 19 credit unions were nonetheless operating in New York by September of 1915.

It was becoming increasingly clear to the movement's most ardent supporters that, to achieve its full potential, a concerted campaign would be necessary to accomplish two critical tasks. First, while a handful of states like Massachusetts, New York and North Carolina had solid credit union enabling legislation in place by the end of the 1910s, most Americans still did not live in a place where it was legally possible to start a credit union. To rectify this, a lobbying effort was necessary. Second, while groups that had formed credit unions had found them to be of great use, there were few places where people interested in starting new credit unions could turn for support.

At this juncture, Edward Filene stepped up to play a leading role. Born in 1860 to a Jewish immigrant shopkeeper, as a young man Filene had been forced to give up his dreams of studying at Harvard to take over the responsibilities of the family business when his father fell ill. Though his formal education had ended early, he turned out to be both a voracious autodidact and a shrewd businessman, building his father's modest shop into one of the country's most successful and innovative department stores.

By the turn of the century, Filene had developed a strong interest in a diversity of progressive and philanthropic causes, and in 1907 his interest in cooperative finance was piqued on a fact-finding trip to India. While there, Filene met William Robert Gourley, a member of the Indian Civil Service responsible for organizing rural credit cooperatives among Bengali peasants. Filene accompanied Gourley on his work for several weeks, and the experience left a deep impression on him. Upon his return to Boston, Filene corresponded with President Theodore Roosevelt about the possibilities of cooperative credit for people of modest means. He was among the first people with whom Desjardins met on his first trip to Boston in 1908.

In the following years, Filene was involved in a number of projects aimed at promoting the credit union movement in Massachusetts, and by 1919 he felt the time was right to launch a national-scale effort. On May 31, he organized a conference with attendees including former Mint Director George E. Roberts, North Carolina Governor T. W. Beckett and Grand Chief of the Brotherhood of Locomotive Engineers Warren S. Stone, which established the National Committee on People's Banks (NCPB). Primarily funded by Filene and Cosmopolitan Trust President Max Mitchell, the committee's main focus was to secure the passage of federal legislation that would enable the incorporation of "Federal People's Banks" under the supervision of the Federal Reserve Board. The attempt ultimately failed, and by early 1920 the NCPB was, for all intents and purposes, defunct.

The lessons of the NCPB fiasco suggested a change in tactics; rather than pushing for blanket federal enabling legislation immediately, national organizing resources might be better utilized by organizing to get such laws passed on a state-by-state basis. To undertake this effort, Filene established the Credit Union National Extension Bureau (CUNEB) and tapped Roy F. Bergengren to lead the effort.

Bergengren was a 42-year-old attorney who was a relative newcomer to the credit union movement and had begun working for the Massachusetts Credit Union Association the previous year. Bergengren had proved to be a skilled and energetic organizer who got results: in his year on the job, more credit unions were established than in any previous year in the state. In July 1921, Bergengren and Filene met and hashed out the logistics of the project. Filene would guarantee funding for a five-year period, and the organization would focus on three main goals: facilitating the passage of state-level credit union enabling legislation, organizing individual credit unions and ultimately forming a self-supporting national association or federation that would take over responsibility for the bureau's promotion of the interests of the credit union movement.

With funding secured and the objectives clear, Bergengren set to work. Recognizing that political success at the state level required strong advocates with a keen sense of the local political terrain, Bergengren hit the rails for an educational tour in December 1921, spreading the credit union idea and building a network of contacts. The strategy bore fruit, and by the end of 1923, Virginia, Kentucky, Tennessee and Indiana had passed CUNEB-model laws. The legislative gears had also begun turning in a number of other states, and dues-supported state credit union leagues began to form.

As the successes mounted and ever more states were added to the credit union movement, opposition began to emerge, which delayed the implementation of credit union legislation in some states and prevented it entirely in others. The small money lenders (the "loan sharks," as they were derisively referred to by credit unionists) were predictably at the forefront of the lobbying campaigns to prevent the establishment of a legal framework for credit unions, but the responses of the banks were more mixed. As they did not tend to extend credit to the same class of people as credit unions, in many states they were not perceived to be a threat to the bottom line. Indeed, the Georgia Bankers Association went so far as to *endorse* the legislation and issued a pamphlet which argued that the movement merited "more encouragement."

By the beginning of 1930, the strides that Bergengren and the credit union movement had made were remarkable. There were approximately 1,100 individual credit unions spread across the United States, 32 of the 48 states had passed enabling legislation and many of those had active dues-supported state-level leagues that were vigorously promoting the development of new credit unions.

Onto that solid foundation came the unintuitive boost of the Great Depression. As the banking system went into deep crisis, the credit union movement weathered the storm surprisingly well. In November 1931, 512 banks closed their doors, while 30 new credit unions were established. The

Courtesy of St. F.X. Archives

Credit Union movement leader Roy Bergengren, 1941.

solidity of the sector did much to boost the public legitimacy of the model, and the election of Franklin D. Roosevelt in 1932 provided Filene, who had put serious time and resources into supporting Roosevelt's campaign, with the opportunity of a second shot at the federal credit union legislation. If passed, such a bill would allow groups in hold-out states to incorporate through the federal government, giving American citizens the right to form credit unions in all 48 states and the territories.

By this point, banker support for the credit union movement had waned, as bankers began to eye the increasingly profitable consumer installment loan market, and their lobby put up stiff resistance in Washington. However, between Filene's adept behind-the-scenes maneuvering and Bergengren's ability to mobilize the network of grass roots supporters he had developed over the previous decade, the bill squeaked through on the last day of the session and was signed into law on June 26, 1934.

Two months later, an exuberant gathering of credit union leaders from around the US was held at a camp in Estes Park, Colorado. There, in addition to congratulating each other, feasting, singing credit union songs and honoring Filene, they got down to the vital work of hammering out the framework of a national credit union federation to carry the work forward. Its task complete, the CUNEB was folded into the Credit Union National Association and, with Bergengren at its helm, the independent credit union movement set to the task of developing the movement into a significant sector of the American economy. By 2013, credit unions claimed more than 95 million members and a trillion dollars in assets. $

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NEW BEDFORD, MASSACHUSETTS
and the Importance of Local Sources of Capital

By Robert E. Wright

Visitors to New Bedford today are hard pressed to believe that this little port on the Acushnet River in southern Massachusetts once boasted the highest per capita income in the entire United States. The little city (population roughly 100,000) is far from desolate, but for decades it has struggled economically, and the relative dearth of local financial institutions also suggests that its path to renewed prosperity will continue to be an arduous one. Bank branches and insurance agencies abound but, unlike in the 19th and first half of the 20th centuries, they respond to the needs of distant institutions and not necessarily to local interests.

From its inception, the US financial system aided economic growth by linking savers to spenders or investors to entrepreneurs directly via markets for financial securities — like stocks and bonds — and indirectly via intermediaries, especially banks and insurers. Like the rest of the early nation, Massachusetts was home to three types of banks: commercial, investment and thrift (which included mutual savings banks, savings and loans and, later, credit unions). Commercial banks and thrifts were depository institutions that took deposits from savers and made loans to entrepreneurs. Investment banks, by contrast, helped companies to issue financial securities like stocks and bonds and to acquire or merge with other corporations. They also sometimes contained brokerage units that helped investors to buy or sell stocks and bonds from or to other investors.

Of the three major types of banks, investment banks had the least impact on New Bedford, Massachusetts, as no major investment bank was ever headquartered there. The city did support a stock exchange, but apparently only for a short period in the late 19th century. Instead of trading on an exchange, many local stocks traded over the counter. In other words, local brokers or corporate treasurers linked people who wanted to sell shares to people who wanted to buy shares in smaller, local corporations.

The shares of a few larger New Bedford corporations, mostly railroads and textile manufacturers, traded on exchanges in New York or Boston. Residents of New Bedford who wanted to invest in non-local corporations also placed orders with their local brokers, who were few and of little consequence. The first securities brokerage in New Bedford may have been that of Edward L. Baker, established in 1848. Baker sold out to Samuel P. Burt in 1865, and Gardner T. Sanford and Charles S. Kelley took over for Burt in 1884. Morgan

Rotch (pronounced "roach") also established a stock and note brokerage in the city after the Civil War, and the city's commercial banks also executed stock and bond trades for their customers, many through Boston investment bank Kidder, Peabody.

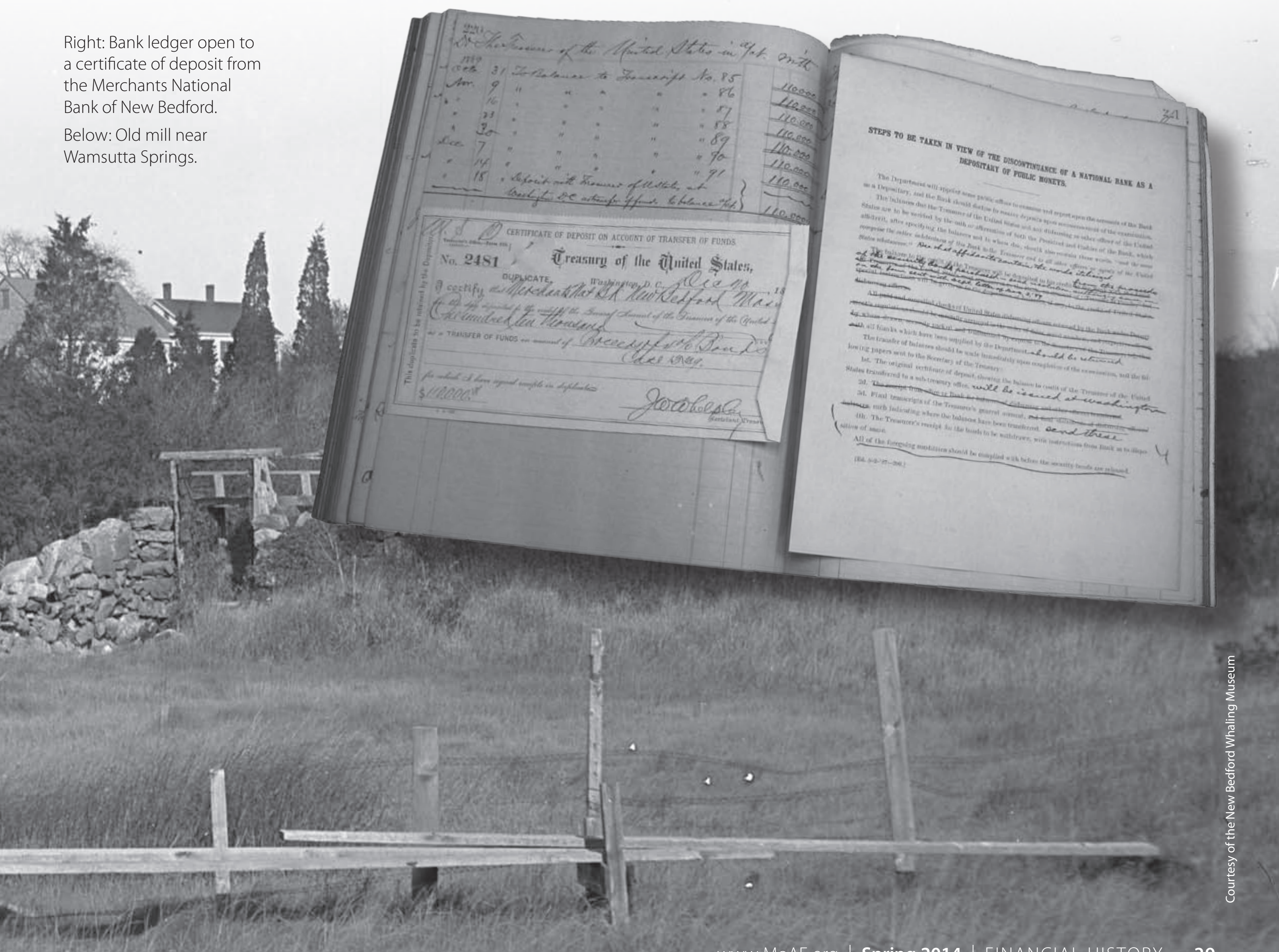
In contrast to investment banks, which left little mark on the city, several important commercial banks and thrifts called New Bedford home. Most were branchless unit banks, but a few added a handful of local branches by the early 20th century. Some soon succumbed to competitive or macroeconomic pressures, but others thrived for decades or even a century or more. In 1803, William Rotch, Jr., Samuel Rodman and Edward Pope received a charter for the Bedford Bank and capitalized it at $60,000. It successfully attracted shareholders via a direct public offering (DPO) but allowed its charter to expire. In 1812, a second bank by the same name, capitalized at between $200,000 and $275,000, was founded by Thomas Hazard, Jr., John Howland, Samuel Rodman, Isaac Howland, Jr., William Rotch, Jr. and John Delano, but they chose not to engage in business, likely due to the uncertain economic conditions caused by the war with Great Britain.

Four years later, after hostilities ended, William Rotch, Jr., William Howland, John A. Parker, Cornelius Grinnell and others obtained a charter for the Bedford Commercial Bank, which had an authorized capital between $100,000 and $150,000. It became a national bank, the National Bank of Commerce, in 1864, and served the city until 1898, when it voluntarily liquidated with no loss to its depositors or other creditors.

In 1825, a group including Joseph Rotch, William R. Rotch, William H. Allen and Ichabod Clapp received a charter for the Merchants Bank of New Bedford and capitalized it at between $150,000 and $225,000. The burgeoning economy, grown fat on whale blubber, soon needed additional financial intermediation. So the Mechanics' Bank was founded in June 1831 with an authorized capital ranging from $200,000 to $300,000 by much of the same group that had chartered the Mechanics Insurance Company the prior day. The following year, Joseph Grinnell, James Howland, Charles Russell, John

Right: Bank ledger open to a certificate of deposit from the Merchants National Bank of New Bedford.

Below: Old mill near Wamsutta Springs.



Courtesy of the New Bedford Whaling Museum

Price and others received a charter for the Marine Bank.

Most of the city's commercial banks survived the Civil War and became national banks. The Merchants Bank, for example, became one of New Bedford's most important financial institutions and remained in business and independent well into the 20th century, even surviving the Great Depression. Thanks to the New Bedford Whaling Museum, the bank's extensive records were recently saved and carefully catalogued. Its records reveal, among other things, who the bank's stockholders were and who it made loans to and took deposits from. Its multitudinous volumes are replete with references to the residents of New Bedford, Fairhaven and surrounding communities.

Unlike some banks in eastern New England, Merchants was not the creature of a small group of industrialists. From 1858 to 1860, the bank lent to more than 3,000 different economic entities such as individuals, unincorporated businesses, corporations and governments, including major merchants, whalers and manufacturers like Wamsutta Mills and Pacific Mills. The bank made loans to railroads, including some in the Midwest, and it also lent to local savings banks and governments, particularly those of New Bedford and nearby Fall River.

Most of the bank's directors, presidents and cashiers were, like the leaders of other successful New England banks, above reproach and extremely accomplished. Cashier James B. Congdon, for example, was by 1851 considered one of the most efficient of the practical bankers in Massachusetts. His pamphlet on a pending banking bill was republished and called "a valuable contribution to the banking literature of the country" by *Bankers' Magazine*. In the pamphlet, Congdon advocated safe banking practices, including higher bank capitalization, and argued in favor of increased competition among banks. He served as the bank's cashier from its inception in 1825 until his resignation in 1858 at age 55 and was called as an expert witness in a suspected forgery case. Congdon was also one of the founders and leaders of a large group of bankers dedicated to the suppression of counterfeiting.

The high quality of the bank's leaders is directly attributable to the stockholders who elected them. In the 19th and early 20th centuries, stockholders in many companies used their voting rights to exert considerable influence over the conduct of their institutions. That changed at some large corporations in the late 19th and early 20th centuries but remained true at many smaller institutions, including community banks such as Merchants. The bank's stockholders—like those of other successful New England banks—were typically local, from southern New England if not New Bedford proper, and most were long-term investors as well as borrowers and depositors.

Courtesy of the New Bedford Whaling Museum

New Bedford Five Cents Savings Bank.

Between the bank's founding in 1826 and 1848, for example, the number of stockholders in any one year ranged from 107 in 1828 to 162 in 1836. Between 1826 and 1848, 346 different entities owned between one and 1,000 shares. Their average holding period was 9.35 years, the average number of shares they held was 24.9 and the median shareholding was 10. Similarly, between October 1880 and October 1892, 776 different entities, including 343 women and 26 institutions (primarily banks, churches and schools), owned between one and 1,111 shares in the bank. The average holding period for all stockholders was 14.3 semi-annual dividend cycles, the median 14 and the mode 25 cycles (the full 12 years). The average number of shares owned was 19.52 and the median 9.21. Women and institutional investors actually owned more shares on average than individual male shareholders did.

In other words, the bank's stock turned over very slowly, and much of it was held by long-term investors who had incentives to carefully monitor the bank's operations. If the bank failed, they would lose their deposits and access to loans as well as their shareholdings, and the subsequent disruption to the local economy could also have imposed considerable indirect costs upon them. Corporations owned mostly by distant or speculative stockholders tended to be much less stable.

Savings banks also aided local economic development, even though they were essentially tools for channeling funds from the poor to the rich. Most were mutual corporations, and hence owned by depositors, but generally they were controlled by wealthy trustees and their business model was to fund mortgage loans and securities purchases with deposits. There was nothing necessarily insidious about this: widows and orphans, working men and increasingly many middle class professionals voluntarily deposited money in such banks in order to earn a fairly good and fairly safe, if somewhat illiquid, return on their investment. Unlike the building and loans, however, savings banks were not a source of microfinance. In 1825, New Bedford residents including William Rotch, Gilbert Russell, Benjamin Rodman, George Howland and John A. Parker obtained a charter for the New Bedford Institution for Savings. New Bedford Five Cents Savings Bank, another mutual savings bank, received a charter in 1855 with help from A.M. Seabury,

Courtesy of the New Bedford Whaling Museum

The New Bedford Institution for Savings, on the corner of William and North Second Streets.

George Howland, Jr., William H. Taylor and others.

By 1889, New Bedford's commercial and savings banks had an aggregate capital and surplus exceeding $20 million. As noted, one of the commercial banks closed, but in 1899 both savings banks were still going strong. The Five Cents had assets of almost $7 million and the Institution for Savings had assets of almost $14.4 million. Moreover, two building and loans formed in New Bedford in the 1880s, the New Bedford Cooperative in 1881 and the Acushnet Cooperative in 1889. The former paid investors 6.5% through the end of its first decade.

In the 1870s and 1880s, Attleboro, Fall River, Mansfield, Taunton and a few other Bristol County communities also witnessed the establishment of building and loans, generally termed cooperative banks in Massachusetts. By the end of 1893, 115 were in operation throughout the state and 5,838 throughout the country, the vast majority of which were — like the two in New Bedford — small, local concerns. Specifics varied over time and from state to state, but almost all building and loans were mutual corporations (or, owned by their customers), and they all channeled funds for building new homes from one group of consumers to another. (Think of Bailey's Building and Loan of Bedford Falls in *It's a Wonderful Life*.)

In 1887, the New Bedford Safe Deposit and Trust Company received a charter and an authorized capital of $100,000 that was quickly raised to $200,000. In this context, trusts were essentially banks that could not issue bank notes and that specialized in investing money for trustees, administrators and executors. The Deposit and Trust was still in business in 1905, as were three of the city's commercial banks, all of which sported solid earnings and good stock prices.

Whaling permeated the entire New Bedford financial and corporate scene before the Civil War. As the whaling industry faded, a process that took several decades after peak production of $6.1 million in 1857, the financial institutions already in place financed the local economy's transition to scalloping and fishing by lending, for example, to fishers who financed their daily operations by mortgaging their boats. But the city's indigenous financial institutions went much further by helping the city's entrepreneurs to shift into textile manufacturing, which by 1885 included 420 establishments with an aggregate physical capital valued in excess of $15 million, some $5 million of which was invested in machinery and another $3.3 million in land and buildings. In terms of number of spindles in operation, New Bedford's factories were second only to those of Fall River and Lowell, and it ranked fourth, behind Lowell, Fall River and Manchester, New Hampshire, in number of looms. Much of that physical capital was locally financed and controlled by people with significant stakes in the region, if not in New Bedford proper.

Other types of manufacturers, from cut glass to copper and fertilizer to oil, were also present in the city, but textiles carried the city's economy until the 1920s, when many manufacturers began to shift operations to the lower cost and less unionized American South. Fishing and sundry light industries, aided by the wartime and post-war economic booms, kept the city together for a few decades, but by 1950 New Bedford suffered unemployment rates much higher than the national average. It had not recovered when all types of US manufacturing entered a long decline, and fishing was hurt by regulations and a decrease in the productivity of key fisheries.

Local financial institutions, by the 1980s mostly appendages of larger institutions headquartered elsewhere, could not help New Bedford to transition when deindustrialization kicked into high gear in the 1960s, '70s and '80s. The Merchants Bank, like the city's other financial institutions, eventually lost its independence when it was acquired by BayState in 1966. More mergers followed after the state's branching restrictions were lifted in 1983 and 1984, and yet more occurred after the Riegle-Neal Interstate Banking and Branching Efficiency Act » *continued on page 36*

Dominick & Dominick

The History of an Enduring Wall Street Firm

By Bart Ward

When the first edition of the *Wall Street Journal* was published on July 8, 1889, several companies took out front page ads. Today, only two of them remain: Rand McNally and Dominick & Dickerman (D&D), the latter of which was known for years as “the oldest continuing member of the New York Stock Exchange (NYSE).”

Founded on June 15, 1870 by William Gayer Dominick and Watson B. Dickerman, D&D initially resided at 17 Wall Street. The founders “became active immediately in the organization of the exchange.” Dominick had become a member of the NYSE the prior year, just as the exchange established its first permanent location at 10–12 Broad Street, and Dickerman served a two-year term as NYSE president beginning in 1890. The firm grew up during the “institutionalization of American investment banking,” alongside some of the first nationally-known financial firms including Kidder, Peabody & Co. and Lee, Higginson & Co.

By 1873, D&D had moved twice and landed at 64 Broadway. That May, William Dominick’s brother, Bayard, joined the firm and became a member of the exchange as well. The American securities business was undergoing a great expansion at the time, as it serviced the newly-built railroads and industrial concerns. Vanderbilt, Morgan and Carnegie were on the move, and D&D was becoming increasingly well-known. In 1899, Dickerman retired from D&D, and the firm’s name changed to Dominick & Dominick, thus enabling it to keep its nickname.

By then, D&D was located at 100 Broadway; it was saving its capital, had 10 members and was beginning to underwrite and distribute securities. Over time, D&D would arrange or co-manage new securities underwritings for many of America’s largest companies including American Bank Note, Bon Ami, Crosley Radio, General Motors, International Telephone & Telegraph, Johnson & Johnson, Mack Trucks, Phillips Petroleum, Pratt & Lambert, Shell Union Oil, Timken Roller Bearing and United Alloy Steel.

The 1890s ushered in great change on “the Street,” as industrial and utility companies joined railroads in dominating the securities markets. These companies had big appetites for capital to build plants and expand operations, and they brought out many new issues of stocks and bonds. D&D began to expand nationally and set up offices in several cities — including its oldest and largest branch in Cincinnati — and also established a bond department.

The early 1900s were marked by steel and rail consolidations, a bull market, the Panic of 1907, securities investigations and re-regulation. This would all end by 1913 with the newly-created Federal Reserve and the death of J.P. Morgan. Historian Robert Sobel called this era, “The end of the Golden Age,” as Victorian bankers faded into the past. Investment banking historian Vincent Carosso wrote, “Never again would they [bankers] be so free to conduct their affairs as they had been at the turn of the century, when J.P. Morgan presided over the securities industry. His death in Rome…proved to be far more of a dividing line in the history of American high finance than was generally acknowledged at the time.” All the while, D&D quietly involved itself in NYSE governance, developing its stock business and helping companies like International Nickel and American Bank Note distribute large blocks of stock.

As D&D headed into the 1920s, Bayard Dominick passed away and Bayard Dominick, Jr. took control of the firm. He surrounded himself with men like the well-connected Andrew V. Stout and the knowledgeable Major Barnard. When he retired in the mid-1920s, Stout took the reins of the firm. Along the way, Bernon Prentice had become an important driver of new business for D&D, and he made valuable connections to the duPont family and William Durant, co-founder of General Motors.

While securities trading was central to D&D’s business, it was also a private banking firm. Historian Susie Pak describes this world in her book, *Gentlemen Bankers*, saying, “A private banking partnership was not simply a job. It was an identity that required constant vigilance, a process or mode of becoming, that was fragile because of its dependence on relationships to others. If private banking was a way of life, a banker’s social ties were as much a statement of his identity and reputation as his economic associations.” In short, the senior partners at D&D gained their influence through their standing in the financial community, which allowed them to operate their style of business.

The firm’s partnership would expand during the 1920s as American businesses grew and large loans were made to war-torn Europe. Challenged by rising upstart securities firms, conservative private banks like J.P. Morgan and Kuhn, Loeb found themselves in a new environment. By then D&D had 500 employees and occupied four floors at 115 Broadway. The firm tiptoed into the management trust business while Wall Street was going wild

Courtesy of Dominick & Dominick

Courtesy of Dominick & Dominick

Left: William Gayer Dominick
Right: Bayard Dominick, Sr.

during the greatest bull market in history.

Sobel referred to the years leading up to the Crash of 1929 as the "Triumphant Years of the Giant Bull," and NYSE historian James Buck called the period from 1923-40 "Boom, Bust and Reform." For D&D, the years following the crash meant more "time was spent on Governmental laws in the making" and tightening of the belt. While many firms and reputations crashed along with the market, D&D's conservative business practices allowed them to survive.

As a result of the numerous scandals associated with the Great Crash, Gayer Dominick, a member of the firm and director of National City Bank (now Citigroup), urged the NYSE to appoint outside governors. A committee of five non-members — including Gayer — was created. The NYSE constitution was eventually altered to "elect four governors from outside," and again Gayer was included. He would serve under NYSE Presidents Richard Whitney, Charles Gay and William Martin.

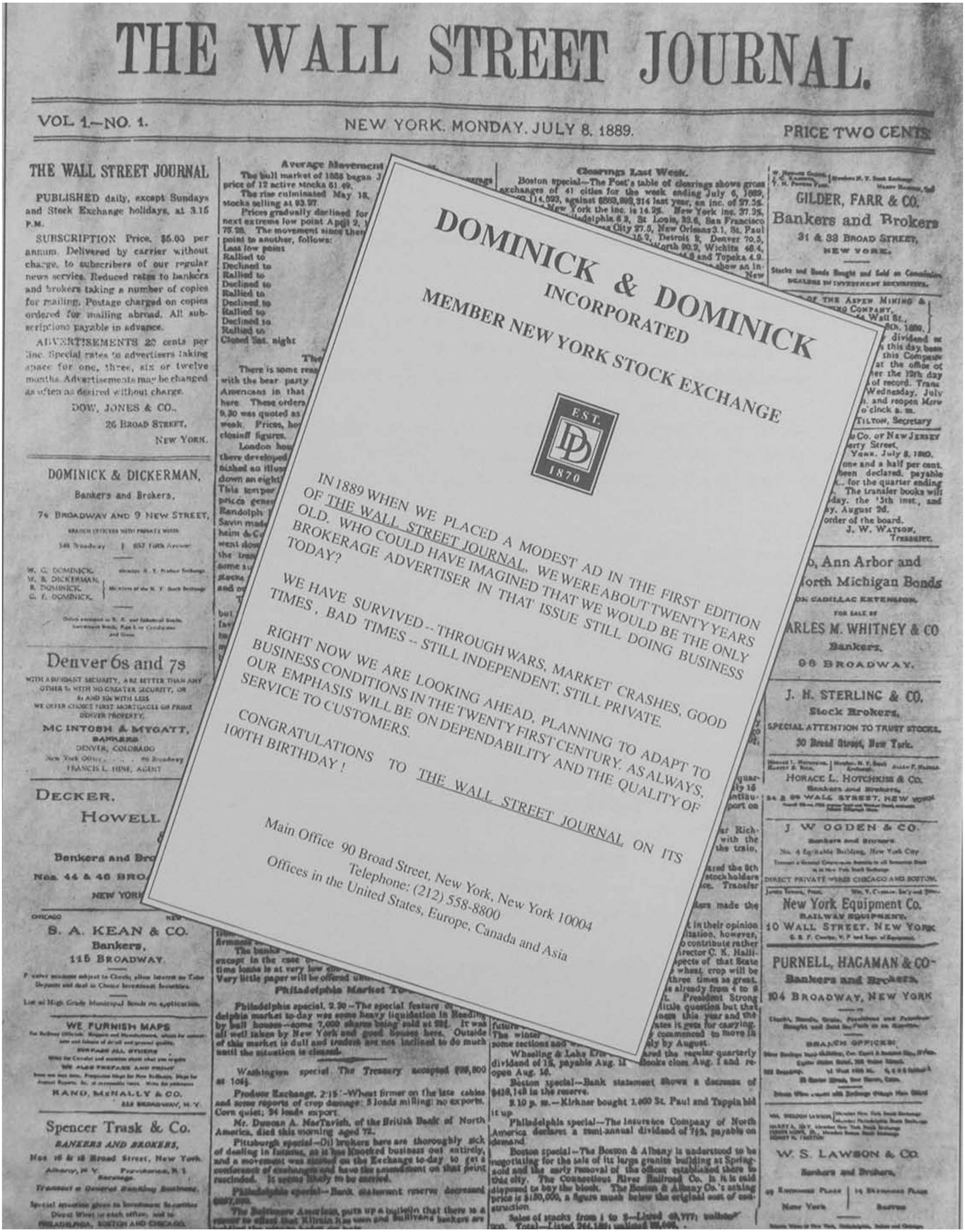
The mid-to-late 1930s redefined D&D, as it became an international house when it opened a branch in London. Then, in 1936, the Basel, Switzerland-based A. Iselin & Co. (founded in 1852) became part of D&D. According to Gayer, "This acquisition of the Iselin business marked a distinct phase in the development of D&D and broadened its field from brokerage and underwriting to include a large safekeeping business, larger than many of the trust companies and a holder of large free credit balances for foreign account." The company also opened an office in Paris and operated Dominick Corporation in Canada.

With the creation of the SEC in 1934, new regulations on Wall Street and the advent of WWII, D&D's business — like that of most other financial firms — went into contraction. The company closed its offices in London and Paris when the war began, and some employees from its Swiss office moved to its New York headquarters. D&D moved its main office to 14 Wall Street during the early years of the war when the number of employees and partners was down to 156, due in part to many entering the military. The firm eventually closed all of its branch offices, although the Canadian operation remained.

A new era for post-WWII America was in the offing, as Western and Eastern

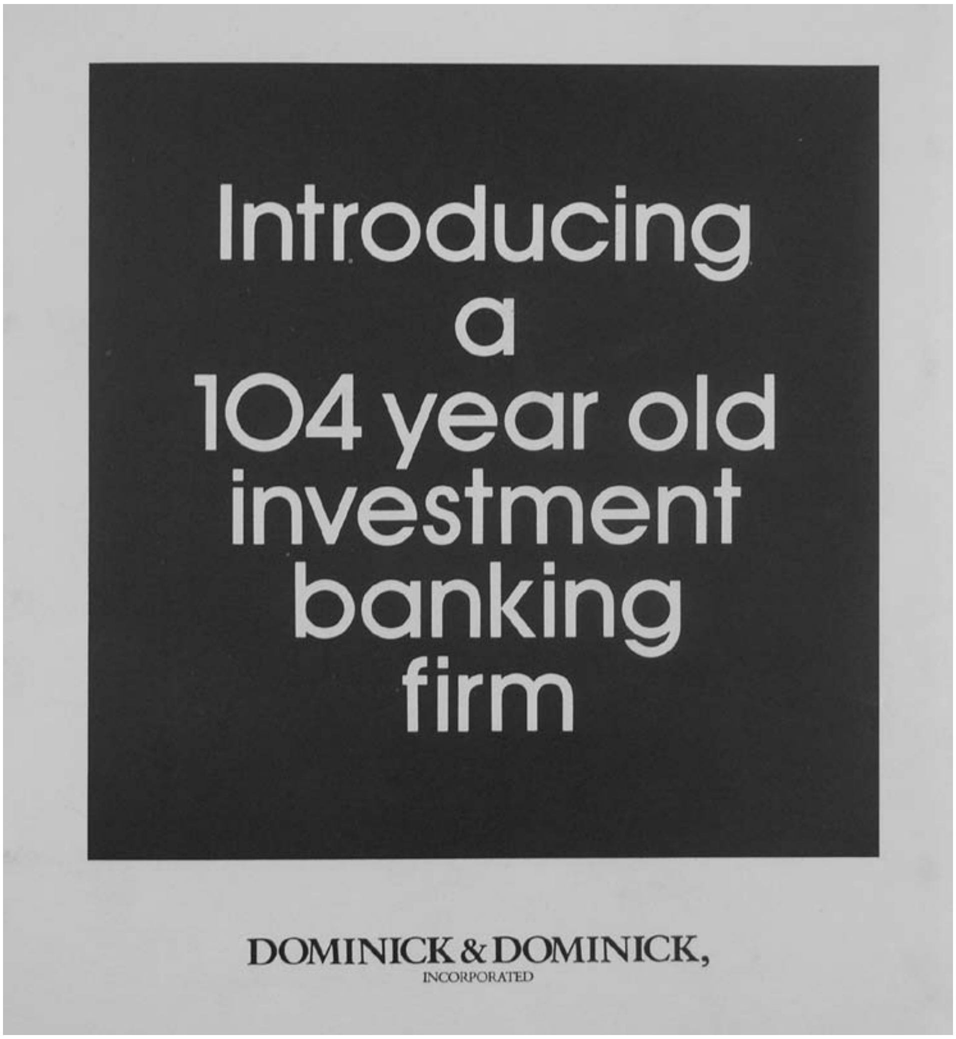
Courtesy of Dominick & Dominick

Wood cut showing lower Broadway in 1876, the year D&D moved to 64 Broadway.



Courtesy of Dominick & Dominick

Dominick & Dominick advertisement commemorating the 100th anniversary of the *Wall Street Journal* in 1989.



Courtesy of Dominick & Dominick

Dominick & Dominick advertisement, 1974.

Europe, Russia, Philippines, China and Japan were in tatters. The US would go from having 25% of the world's gross domestic product before the war to over 70% in the post-war years. Wall Street also became closer to Main Street as the retail stock business grew, and privately-held firms like D&D found their niche in the new financial order.

By the 1950s, D&D had developed a strong back office and served a distinguished clientele. Among other strengths, the firm had a prestigious line of partners through its many years in investment banking, corporate finance, securities execution, research, trading and asset management. They also had a huge bank vault because securities were still processed as paper documents. The firm expanded once again and was involved in a number of important deals, which included Alexander Smith Carpet, Great Plains Oil and Arvida Corporation.

Wall Street underwent a great transformation by mid-century, reacting to multiple rounds of investigation and regulation and changing from a paper-based business to one that embraced new technologies. D&D transformed itself as well, from a partnership to a corporation — still privately held — and also expanded its retail US operations, which allowed for revenue growth.

Business boomed in the early 1960s, with numerous new securities issues. In 1962, D&D opened an office in Chicago and then acquired the New England firm of Townsend, Dabney, Tyson in 1966. This added 15 offices in the US, including a significant operation in Boston. By 1970, D&D had more than 1,000 employees, and its banking clients included Flying Tiger, Louisiana Land, Western Airlines, LTV, The Oliver Corporation and MGM.

Peter Maximus Kennedy served as Chairman and CEO of D&D during Wall Street's "Paperwork Crunch" of the late 1960s and early 1970s, by which point the firm had opened 30 US branch offices. The "crunch" was a result of the brokerage industry's inability to process transactional-based paperwork. Many firms including McDonnell & Company; Dempsey-Tegeler; Hayden, Stone & Co.; F.I. DuPont; and Goodbody & Co. were in serious trouble. Kennedy retrenched and saved D&D, as he did again in 1973 when a major investor left the company. Kennedy eventually purchased controlling interest in D&D and sold four of the firm's five NYSE seats and one of its two American Stock Exchange seats. He told *The New York Times* that "a national retail structure is not right for a firm of our size. We either had to be bigger or smaller… We are not going out of business. We are just changing the nature of our business."

During the mid-1970s, Kennedy bought Drexel Heritage Furnishings and successfully sold it in the mid-1980s along with other holdings. Also in the 1980s, Kennedy founded Eighteen Seventy Corporation. The family-owned firm controlled Ferguson Copeland and Guy Chaddock, which produced high-quality furniture. Dominick Company AG, a private Zurich bank, is also part of Eighteen Seventy, along with other assets including GI Ranch Corporation in Oregon.

Edmund Kelly, the legendary White & Case partner who defended companies against hostile takeovers, joined D&D during the "hostile takeover era" of the 1980s. Clients included Warner Lambert, Pepsico, Quaker State Oil, Chicago Pneumatic Tool and Federal Paper Board. D&D also counted among its corporate finance clients the Asian companies of Cheung Kong, Hang Leung and Orient Overseas Container Group.

In the late 1980s and 1990s, D&D was headquartered at 90 Broad Street in Lower Manhattan. In 1991, the firm spun off a number of its branch offices to a few operational employees and called it Prentice-Dominick Securities. D&D was changing again as the bull market of the late 1990s turned into a giant speculative game in the Dotcom era. This ended in the recurring theme of crash, investigation and re-regulation.

In 2003, Mike Campbell, who headed the private client department at Donaldson, Lufkin & Jenrette and Credit Swiss, joined the firm and built a private client business. He continues to serve as non-executive chairman. Kennedy passed away in February 2009; his sons, Peter and Paul, took the » *continued on page 37*

Value Investing

continued from page 23

Bach, Graham and Beyond

Classifying the different eras of a popular school of thought is a subjective endeavor, and as such frequently requires anchoring to key dates. For example, the Baroque Era of music "officially" ended with the death of J.S. Bach. Maestro Bach, of course, never knew that his death would end an era any more than Benjamin Graham could have known that some future authors would date the close of the Founding Era of value investing with the 1973 edition of his classic book, *The Intelligent Investor*. Nevertheless, such classifications are useful for both practitioners and researchers, especially when contemplating what the future may hold.

Whether the future develops as we have theorized, and value investing comes to influence and define corporate management or not, investors and corporate managers can benefit from studying the lessons of Graham and his followers over time. Their school of thought has been applied to a variety of asset classes and market environments and, when it has been applied skillfully, it has helped to produce exceptional returns at relatively low levels of risk. $

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Frederick J. Sheehan is the author of the Panderer to Power: The Untold Story of How Alan Greenspan Enriched Wall Street and Left a Legacy of Recession *(NY: McGraw-Hill, 2009; Chinese translation, 2014), serves on several investment committees, and is the author of speeches, articles, and interviews on his website, AuContrarian.com. He can be contacted at fsheehan@Aucontrarian.com.*

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New Bedford

continued from page 31

was passed in 1994. New Bedford-based banks were all but obliterated by the financial industry's consolidation.

Big banks with national or regional footprints now dominate the local scene. Even many of the city's lesser-known banks are headquartered elsewhere. Admiral's Bank is out of Boston; BCP is headquartered in New Jersey; Eastern Bank is from Salem and Webster Bank from Waterbury. That has hurt the city's efforts to rebound because the remaining institutions — St. Anne Credit Union, BayCoast Bank, Bristol County Savings and St. Anthony-New Bedford Federal Credit Union — are too small to matter much to large or growing businesses.

The second largest bank, BayCoast, barely had $1 billion in assets as of the end of the first quarter of 2014 and the largest, Bristol County Savings, had assets just over $1.5 billion at that time. While a billion may sound like a lot, 101 US financial institutions had assets greater than $10 billion at the end of May 2014. St. Anne dates back to 1911, a long time for a credit union, but it has assets of only about $18 million. And like other credit unions, it can't lend much to businesses.

New Bedford and its surrounding area was heavily taxed and regulated and largely devoid of local innovative sparks as most of its banks, insurers, hospitals and universities were mere branches of institutions headquartered elsewhere. Much of the indigenous human and financial capital, once copious, has long since passed on or moved away. The city is currently in dire need of some "Rotches," not the six-legged variety, but people with money and business acumen who care about the community and can command sizeable sums through intermediaries. $

Robert E. Wright is the Nef Family Chair of Political Economy at Augustana College in South Dakota and the author of 17 books, including Corporation Nation *(UPenn 2014) and* The Genealogy of American Finance *(Columbia 2015). He has been a member of the editorial board of this magazine since 2008.*

Dominick & Dominick

continued from page 35

helm of the family business. Today, D&D is headquartered in midtown Manhattan, after having moved from the Financial District in 2004. It also has branch offices in Atlanta, Basel and Miami.

In describing D&D's legacy and future, Paul said, "the firm has survived so long, and expects to continue to do so, by focusing on client interests rather than its own interests. Hence, it does not position against clients; its wealth management is open architecture, pulling the best products from 'the Street' rather than manufacturing products as tools of its own P&L at the expense of clients; and long-term relationships with investment banking clients rather than transactional banking. These characteristics will continue — I am sure."

Peter added, "As with any firm lasting nearly 145 years, adaptability has to be at the center of survival since the financial competitive landscape is forever evolving. Adapting to change caused D&D to last as long as it has. My father used to believe that another key is dependability. He highly valued this trait and viewed it as underappreciated." $

Bart Ward is CEO of the Investment Advisory firm of Ward & Company, Ltd. Since 1993 he has written the weekly Wall Street history and market-oriented column, "The Corner." He has his degree in history from UCLA.

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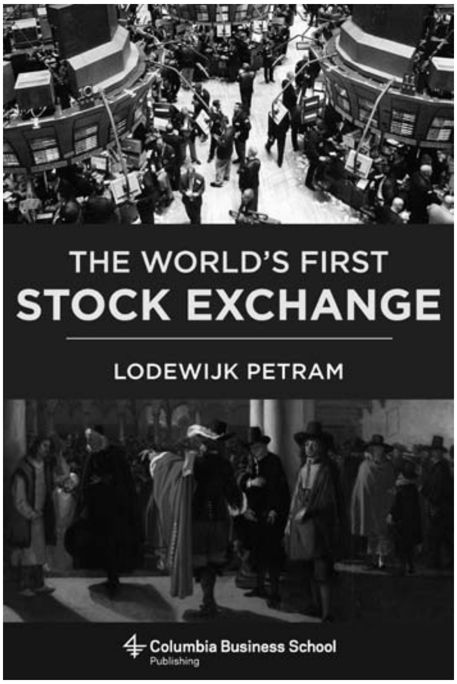
BY KENNETH SILBER

The World's First Stock Exchange



By Lodewijk Petram,
Columbia Business School
Publishing, 2014
304 pages with illustrations,
notes, bibliography and index

Talk about a ground-floor opportunity. In 1602, residents of the Dutch Republic could buy shares in the new Dutch East India Company (Vereenigde Oost-Indische Compagnie, or VOC), which had been granted a monopoly on Dutch trade with Asia. In so doing, they were participating in the beginning of the first real stock market.

Whereas previous shipping ventures typically focused on a single voyage, the VOC had a longer time horizon: initially 20 years, with an option for investors to cash out after 10. (The company lasted nearly two centuries.) Lest that timeframe worry investors, the VOC's directors included a provision, not explicit in earlier enterprises, for "conveyance or transfer" of shares — meaning they could be sold.

The World's First Stock Exchange, by Dutch economist and historian Lodewijk Petram, is a lucid and absorbing account of how a sophisticated equity market developed in 17th century Amsterdam. Trading in VOC shares gave rise to market makers, brokers, forward contracts, short selling and options trading. There were bear raids, worries about widows and orphans, lawsuits and a frantic scramble for information even without phones, cable news and Bloomberg terminals.

The market had barely gotten off the ground before cases of fraud were being litigated. A man named Hans Bouwer was an innovator in securities crime, working with a corrupt VOC bookkeeper to sell the same shares to multiple people. The legal wrangling that resulted helped to clarify several points. Among them was that the buyer of a share was not responsible for investigating the history of transactions in that share.

Petram traces the rise of a Jewish community of traders and investors, with roots in Portugal and Spain, distinct from the Protestant community that initially dominated the Amsterdam market. He argues that the rise of brokers resulted in large part from the need for intermediaries between these groups, as market participants no longer did business only among people they knew well.

The 1688 book *The Confusion of Confusions*, by Joseph Penso de la Vega, a Jewish Amsterdam merchant of Spanish background, has shaped modern awareness of the early Dutch stock market. Petram suggests that claims for this classic as a history or investment guide may be exaggerated, but that its value lies in its uniqueness and sense of drama.

There is much drama too in *The World's First Stock Exchange*, replete as it is with anecdotes about the strivings and clashes of long-ago market participants. These are based on laborious research into handwritten documents from the era. Petram acknowledges "slightly romanticizing" the anecdotes, for example in speculating about the emotions of a maid who is listed among the first investors.

There were notable financial crises in 1672 and 1688. The former occurred when the Republic was at war with England and France, and political unrest swept Dutch cities. The VOC share price (an index based on 100 at the 1602 offering), which had hovered around 500 in 1671, dropped to 290, its lowest level since 1637. The meltdown, Petram notes, had much in common with the 2008-09 Financial Crisis, with market players freezing amid uncertainty as to who was a viable counterparty. (A similar lack of confidence also marked the end of the 1637 tulip mania.)

In 1688, the VOC share price dropped from 565 to 414 on fears of renewed war with England. As it happened, the Dutch potentate William III of Orange was successful in invading England and becoming its king. In the next couple of decades, London began to overshadow Amsterdam as a financial center, a development that may have been aided by Dutch financial talent following William there.

Petram suggests that Amsterdam's stock market florescence did little to boost the Dutch Republic's overall prosperity in the 17th century. This is surprising but plausible. The market never expanded much beyond the VOC, which for its part never tapped investors for additional capital. A 1621 offering by the Dutch West India Company went poorly. Unlike these two huge trading concerns, other companies in that preindustrial time usually did not need vast upfront capital.

The World's First Stock Exchange does not extend into the VOC's long-term decline and 1799 bankruptcy. Such a tying up of historical threads would have been interesting. Still, in its focus on the 17th century Dutch stock market, this book gives a fascinating look at a remarkable episode in financial history. $

Kenneth Silber is senior editor at Research, *a magazine for financial advisors, and is a two-time winner of the Excellence in Financial Journalism Award from the New York State Society of Certified Public Accountants. He is working on a book about DeWitt Clinton and the Erie Canal.*

HOW MUCH DO YOU KNOW ABOUT FINANCIAL HISTORY?

TRIVIA QUIZ

By Bob Shabazian

1. Who invented the first stock ticker machine?

2. Prior to the invention of the steam-powered engine, how were the first American trains moved from one location to another?

3. Who coined the phrase “robber barons” in writing about wealthy tycoons?

4. What government action in 1867 was known as Seward’s Folly and Seward’s Icebox?

5. Where was the secret meeting held that led to the founding of the Federal Reserve?

6. What tax did the Sixteenth Amendment to the Constitution ratify in 1913?

7. How many times in 2013 did the Dow Jones Industrial Average close at a record high?

8. What value investor is known as the “Oracle of Omaha”?

9. How many central banks has the US had?

10. Who was the second US Secretary of the Treasury after Alexander Hamilton?

1. Edward A. Calahan, in 1863 **2.** They were pulled by horses **3.** Matthew Josephson (1849–1978), a political and economic historian **4.** The purchase of Alaska for $7.3 million under Secretary of State William Seward **5.** Jekyll Island, off the coast of Georgia **6.** The income tax **7.** 52 times **8.** Warren Buffett **9.** Three: The First Bank of the US, the Second Bank of the US and the Federal Reserve **10.** Oliver Wolcott, Jr.

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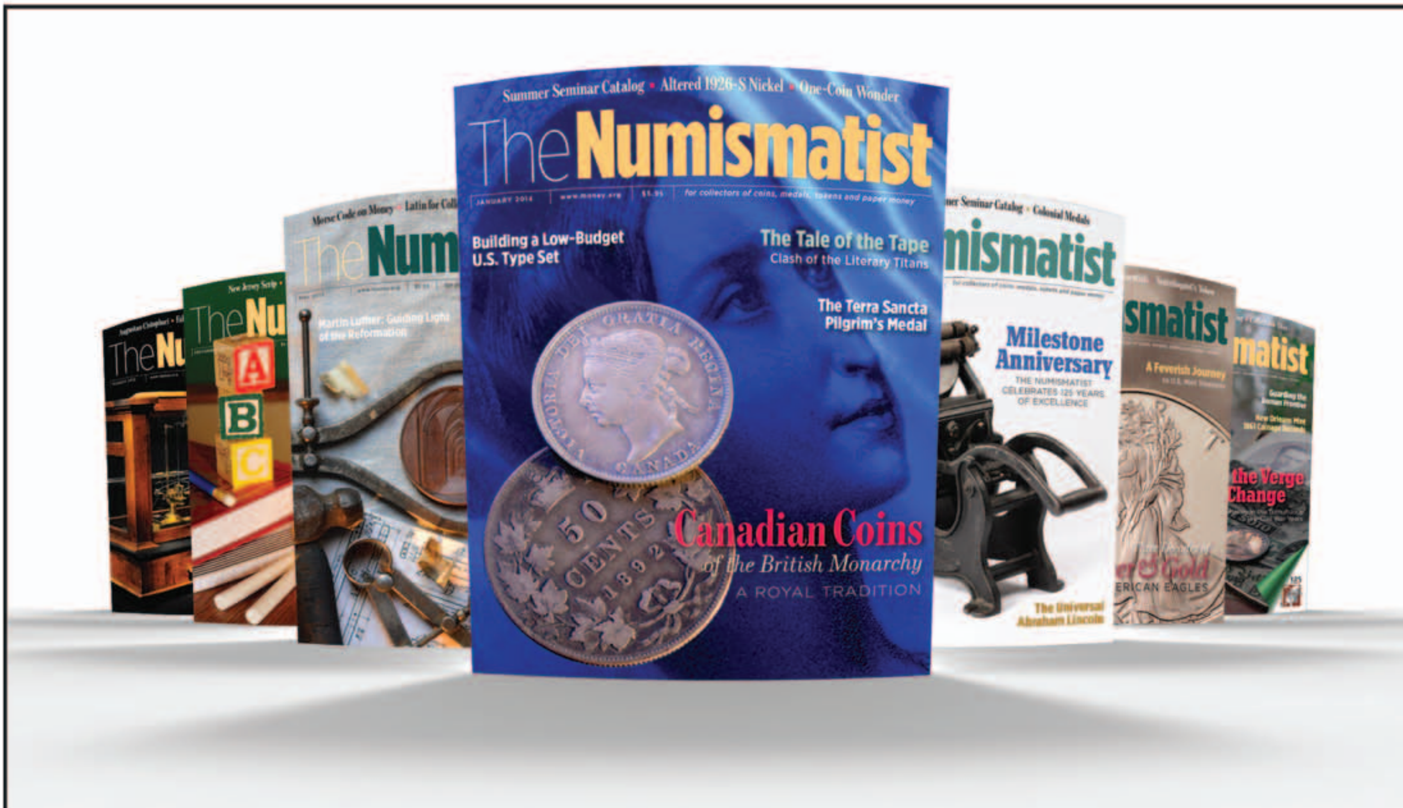

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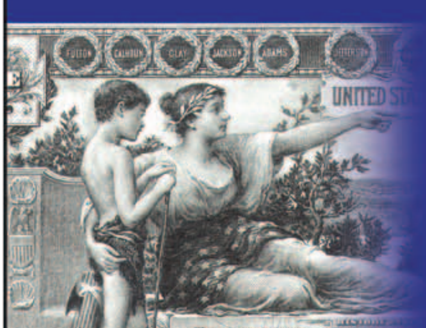

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